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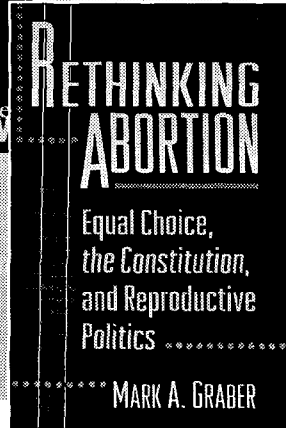
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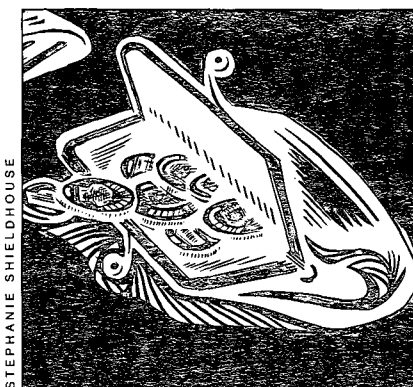
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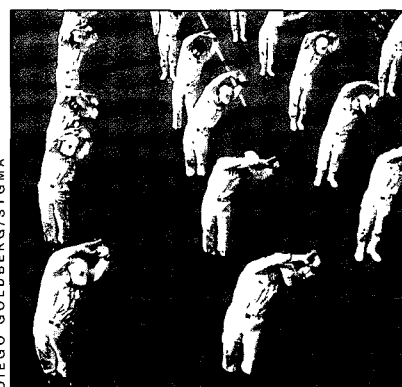
FALL 1999 VOL. 17 NO. 4



LLOYD WOLF



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COVER PHOTOGRAPHY BY FRED DANA

Sustaining the Good Economic News

THE REMARKABLE PERFORMANCE OF THE U.S. economy in the late 1990s—the simultaneity of strong growth, low unemployment, and quiescent inflation—has everyone asking “How long can the good news last?” Are we enjoying some brief moment of serendipity when the economic stars happen to be aligned? Or is there something we can do to keep the strong performance going?

The past couple of years have been a convincing demonstration of the benefits of supertight labor markets. When workers are scarce, those with less skill and experience get a chance to show what they can do. They acquire skills and work histories that they would never have had if unemployment were higher and employers could be more choosy. Workers at all levels get opportunities to move to better jobs, obtain more training, and switch to new careers or other parts of the country with less risk of winding up jobless. With the unemployment rate below 5 percent for more than two years, welfare rolls have plummeted and those with the least skill and education have

finally begun to see their incomes rising.

More remarkably, recent experience has called into question the usual assumption of economists that tight labor markets are bad for productivity growth because they force employers to scrape the bottom of the proverbial barrel and make do with employees with less skill, experience, or attachment to the labor force. Under current conditions of fierce

global and domestic price competition and rapid technological change, the scarcity of workers may actually be forcing employers to use workers more intelligently, to reorganize their workplaces, substitute machines (especially computers) for people, enhance worker skills and responsibility, and end up with more productive operations.

Recent experience has also reminded us that low inflation enhances the ability of businesses, individuals, and governments to plan ahead. Low inflation means lower interest rates and favors long-term investment. Moreover, because inflationary expectations tend to be self-fulfilling, low inflation makes it easier to have more low inflation.

The pleasant surprise of recent years is that the U.S. economy has proved far less inflation prone than most economist thought it would be at such low unemployment rates.



Alice M. Rivlin, a senior fellow in the Brookings Economic Studies program, recently resigned as vice chairman of the Federal Reserve Board.

Some of the reasons reflect the current state of the world and are likely to be temporary. The high value of the dollar has made imports cheap and put strong downward pressure on the prices of domestic products that compete with imports. The deep recession that followed the fiscal crises in Asia, Latin America, and Russia has kept commodity prices low. As the world recovers, Americans are likely to find imports, including commodities, more expensive and their own price level rising more rapidly as a result.

Other anti-inflation forces are likely to prove more lasting. Technology continues to shrink the significance of distance and the cost of information. Price competition in product markets will only get more and more fierce as customers learn to use the internet to get the best deal in ever-widening markets. Deregulation and freer movement of products, capital, and even labor are almost sure to keep putting downward pressure on prices, here and abroad.

But at least part of the answer to the question how long can we keep labor markets tight without rekindling inflation. What can we do?

For openers, we can keep running a substantial surplus in the federal budget and retire a significant portion of the national debt. Reducing the national debt will put downward pressure on interest rates and foster the long-term investment that we so urgently need to have a more productive economy as our population ages. This is certainly an inopportune time for a major tax cut—whatever one's beliefs about the desirable size of government. A big tax cut would only make an already hot economy

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run hotter and make it more likely that the Federal Reserve would raise interest rates to ward off future inflation. The Fed has so far been quite restrained about raising rates in the face of record low unemployment rates. But why make their job harder and risk combining tighter monetary and looser fiscal policy to the detriment of future growth?

State and local governments also have a chance to act prudently as strong revenues roll into their treasuries from the vibrant economy. They can build up their rainy day funds, retire debt, and invest in needed infrastructure.

But it is a mistake to think that only governments make economic policy. The combined actions of many different kinds of economic actors will be needed to maximize the chances of keeping the good news flowing. Workers and potential workers can acquire more skills and education at all levels. They can take the risk of moving to better jobs or starting new businesses. Companies can focus on cutting costs and increasing productivity: they can foster research and innovation; they can offer training and employee incentives to acquire more skill and education. Colleges and universities, community colleges, and technical institutes can offer courses at times and in places convenient for workers and “nontraditional” students. Communities large and small can diversify their economic bases, upgrade and modernize their school systems, and welcome new kinds of workers and companies.

There is no guarantee that the good news will keep flowing—it's unlikely that the business cycle has disappeared forever. But there are plenty of actions that, taken together, will increase the probability that the economic outlook stays positive most of the time. ■

Correction

In “The Birth of the Euro” (Summer 1999, page 27), Robert Solomon wrote, “Neither the ECB nor the Federal Reserve Board undertakes market transactions directly.” Although that has been correct so far, the European Central Bank, in contrast to the Federal Reserve Board, has the power and the facilities to buy and sell financial instruments in markets and with financial institutions.

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*Design and art direction by
Jeffrey Kibler/The Magazine Group*

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Printed in U.S.A.

*Subscriptions: one year \$17.95
(\$24.95 foreign); two years \$32.95
(\$46.95 foreign); three years \$47.95
(\$68.95 foreign). (800) 275-1447;
(202) 797-6258*

Postmaster, send address changes to:

*Brookings Review,
1775 Massachusetts Ave., N.W.,
Washington, D.C. 20036*

Second-class postage paid

at Washington, D.C.

USPS I.D. No. 010-099;

Publication No. 551640.

Reprint permissions: (202) 797-2483

*U.S. newsstand distribution by:
Ingram Periodicals Inc.
1117 Heil Quaker Blvd.
La Vergne, Tenn. 37086
(800) 627-6247 (ext. 4500)*

*Brookings Review
(ISSN 0745-1253) is published
quarterly by the
Brookings Institution Press.*

*Visit Brookings online at:
www.brookings.edu*

New Trend in Unemployment

The High-Pressure U.S. Labor Market of the 1990s

By Lawrence F. Katz and Alan B. Krueger

The recent performance of the U.S. economy has been nothing short of extraordinary. Both inflation and unemployment reached their lowest levels in 30 years in 1998. And the unemployment rate has been under 5 percent for two years, while inflation has been *declining*.

Lawrence F. Katz is professor of economics at Harvard University. Alan B. Krueger is Bendheim Professor of Economics and Public Policy at Princeton University. This paper is drawn from "The High-Pressure U.S. Labor Market of the 1990s," Brookings Papers on Economic Activity, 1999:1.

ent?

Unemployment in the 1990s expansion (through 1998) is 0.8 percentage point lower than it was in 1989 at the peak of the last expansion.

How are we to account for this combination of low unemployment and low inflation? Has the labor market changed in some fundamental way to lead us to expect that this new regime will continue? Four labor-market explanations for the contemporaneous decline in unemployment and inflation are worth exploring. The first involves demographic trends over the past decade. The second is the surge in the prison population during the 1990s. The third is possible improvements in the labor market that allow better matching between workers and jobs. And the fourth is possible worker reluctance to press for wage gains in this recovery because of anxiety about job prospects.

Changing Demographics

One of the first places economists look to explain long-term movements in the unemployment rate is changes in the age composition of the labor force. Because teenagers and young adults traditionally have much higher unemployment rates than do prime-age adults, changes in the age structure of the work force can affect the unemployment rate. Seminal studies by George Perry and Robert Gordon, for example, showed that the entry of the baby boom cohorts into the labor market helped increase joblessness during the 1960s and 1970s. And recent studies by Robert Shimer and by Robert Horn and Philip Heap suggest that the maturing of the baby boom cohorts has helped lower unemployment in the 1990s.

The rise and fall of the share of young workers in the labor force over the past four decades has been dramatic. The share of those under 25 years of age increased from 16.6 percent in 1960 to 24.5 percent in 1978, and then fell to 15.8 percent in 1997. The average unemployment rates for teenagers aged 16–19 and for young adults aged 20–24 during 1960–98 were 16.8 percent and 9.6 percent, respectively, compared with 4.2 percent and 3.7 percent for those aged 35–44 and 45–54.

What would have happened to

unemployment between 1960 and 1998 if the age structure of the labor force had remained constant? Our calculations reveal that the unemployment rate rose 0.63 percentage point from 1960 to 1979 and then fell 0.69 point from 1979 to 1998 because of age structure changes. How far do these changes go toward explaining why unemployment is lower in the 1990s than in the 1980s or 1970s? They can account for essentially the entire 0.5 percentage point decline in the unemployment rate from the peak of the economic expansion in 1979 to that of 1989. But demographic changes account for only around a 0.2 percentage point decline in unemployment from the 1989 peak to 1998, or about one-quarter of the 0.8 percentage point actual change. That leaves much of the decline unexplained.

Rising Incarceration Rates

Another major demographic shift that could influence the unemployment rate involves the dramatic rise in the U.S. incarceration rate during the past several decades. Figure 1 shows the share of the U.S. adult population in prison or jail from 1947 to 1998. In 1970, 2 of every 1,000 adults were incarcerated; by 1998, the number had increased to 9 of every 1,000. The proportion of the population in prison or jail has doubled since 1985, with men accounting for about 90 percent of those behind bars. To put the magnitude of this social problem in perspective, in June 1998 the number of adult men in prison or jail equaled 2.3 percent of the number in the labor force.

Because people who are in prison or jail are not counted in either the numerator or denominator of the official unemployment rate (which covers only the civilian noninstitutional population), the recent surge in the prison population may have produced a discernible impact on the measured unemployment rate. To the extent that the decline in the official unemployment rate simply reflects the removal from the civilian noninstitutional population of a large number of incarcerated individuals with high unemployment propensities, however, it cannot be interpreted as an improvement in labor

market performance for any given group of people—nor does it take into account the possible lasting negative effects of incarceration on the future labor market prospects of these individuals.

Based on current estimates of the employment and labor force participation rates of individuals comparable to the incarcerated population, we estimate that the increase between 1985 and 1998 in the number of men incarcerated has reduced the total male unemployment rate by about 0.3 percentage point. Because the incarceration rate for women is so much lower than that for men, the rising incarceration rate has probably lowered the overall unemployment rate since the mid-1980s by only about 0.1–0.2 percentage point.

Improved Job Matching

Changes in the functioning of the labor market itself may also account for today's low unemployment rate. Two developments in particular may have improved the matching of workers to jobs over the past decade.

In 1993, Congress began requiring states to implement a Worker Profile and Reemployment Services program to improve the efficiency of the Unemployment Insurance system. The goal was to help identify jobless workers who are likely to have so much difficulty finding work that they exhaust their unemployment benefits. To assist these workers,

FIGURE 1.
Share of U.S. Population
In Prison or Jail, 1947–98

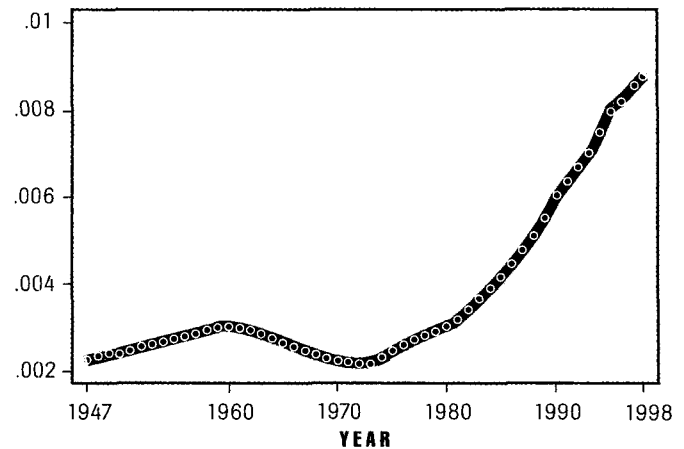


Figure shows ratio of prison and jail population to civilian, noninstitutional population. Authors' calculations based on Bureau of Justice Statistics data, BLS population data, and Richard Freeman, "The Labor Market," in *Crime*, 2nd ed., edited by James Q. Wilson and Joan Petersilia (Institute for Contemporary Studies, 1995).

The increase between 1985 and 1998 in the number of men incarcerated has reduced the total male unemployment rate by about 0.3 percentage point.

worker profiling provides reemployment services, including job search workshops, counseling, job clubs, and referrals to employers. Workers thus identified must avail themselves of these services to be eligible for benefits. States began phasing in worker profiling systems in 1994, and by 1997 essentially all unemployment insurance recipients were profiled. That year 30 percent of benefit recipients were placed in the selection pool for services, and 35 percent of those in the pool were referred to some type of service—the intensity of which varied considerably from state to state. Last year one million workers reported for at least one type of service, and three-quarters of a million completed a service. Could WPRS on such a scale significantly influence the aggregate unemployment rate?

Based on estimates of the effectiveness of job search assistance from a series of random assignment demonstration programs, we calculate that the operation of WPRS systems in 1998 reduced the total weeks of unemployment in the U.S. economy by from 0.5 million to 4 million weeks. During 1998, an average of 6.2 million workers were unemployed each week, producing a total of 322 million weeks of unemployment. Thus the total share of unemployed weeks reduced by WPRS relative to total weeks of unemployment would be

only 0.15–1.24 percent. Had worker profiling not been in effect, the unemployment rate would have increased from its actual level of 4.5 percent in 1998 up to a range from 4.51 percent to 4.56 percent—increments so small as to be nearly indistinguishable from sampling error in the unemployment rate. This is not to say that improving the reemployment system is not a worthy goal, but it does highlight the fact that even cost-effective micropolicy interventions of modest scale are unlikely to have much effect on aggregate outcomes, such as unemployment.

A more promising explanation for improvements in the efficiency of the labor market in the 1990s is the rapid growth of the temporary help services industry. Employment in the industry increased from under 0.5 percent of U.S. employment in the early 1980s to 1.1 percent in 1989 and to just over 2.2 percent in 1998. Temporary help accounted for 8.2 percent of employment growth during 1992–98, as opposed to 4.1 percent in the 1983–89 expansion. By making it easier for firms to locate qualified and screened employees, temporary help services may lower hiring costs, reduce labor market bottlenecks, facilitate better job matches, and put more competitive downward pressure on the wage-setting of incumbent workers.



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8 in the number of men male unemployment rate by about

Unlike the WPRS, temporary help agencies appear to have increased their scale of operations to the point where they can significantly affect the aggregate labor market. Approximately 3.2 percent of employed workers in the February 1997 Current Population Statistics supplement were on-call workers or employees of a temporary help agency or contract firm. Sharon Cohany reports that 60 percent of the 1.3 million self-reported employees of temporary help agencies in the February 1997 CPS were temporary workers for economic reasons. If, in the absence of the expanded temporary help industry, half of these "involuntary" temporary workers had continued searching for work while remaining unemployed, the official 1997 unemployment rate would have risen by around 0.3 percentage point.

Beyond such possible direct effects of shifting workers from job search during unemployment to job tryouts in temporary jobs, the growth of temporary help services may facilitate wage restraint by making it easier for firms to locate substitute workers. The increased ability to establish contingent work arrangements may also allow employers to raise wages for marginal workers working for temporary help agencies without creating internal equity problems that, in the past, may have necessitated increasing the wages of incumbent employees to prevent morale problems.

An indication of the possible importance of the temporary help industry in facilitating wage restraint, and thereby possibly lowering unemployment, is that states such as California and Florida, which had a well-developed temporary help industry at the start of the 1990s, experienced lower wage growth in the 1990s (controlling for cyclical conditions) than did states with only fledgling temporary help industries. Taking into account the wage effects, we estimate that the temporary help industry lowered unemployment by up to 0.39 percentage point over the past decade.

Worker Insecurity

Observers as diverse as Robert Reich and Alan Greenspan have argued that worker insecurity has slowed wage growth during the 1990s. One reason for the increased insecurity might be the decline of unions in the United States. Union membership has fallen steadily since reaching a peak in the mid-1950s. In 1973, 24.6 percent of private-sector workers belonged to a labor union. By 1998 that rate had fallen to 9.6 percent.

During their heyday, unions had great bargaining power, increasing wages not only for their own members, but also for

Implications for Low-Income Workers

In the past few years, as unemployment has continued to fall—and the minimum wage has increased—the much publicized gap between workers at the top and bottom of the wage scale has finally begun to narrow. Real wages have risen across the wage distribution, with lower-wage workers receiving proportionally the largest real wage gains. For workers with lower levels of educational attainment and those in the lower deciles of the income distribution, wage growth is especially responsive to movements in the overall unemployment rate. Lower-wage workers also benefit disproportionately from a tight overall labor market because their own unemployment declines more than aggregate unemployment. Even so, many less-skilled and disadvantaged workers continue to suffer long spells of joblessness in today's buoyant labor market. The average duration of unemployment spells remains stubbornly high.

The labor market developments that have reduced unemployment and contributed to price stability during the 1990s have helped offset the secular fall in demand for less-skilled workers and provided economic improvements for disadvantaged workers and their families. The large expansion of the earned income tax credit (EITC) since 1993 has interacted with tight labor markets to generate more widespread poverty reduction and economic benefits to the disadvantaged in the post-1993 period than in the comparable period of the expansion of the 1980s. But despite these recent improvements, low-wage workers still have not fully regained their real wage levels of two decades ago. And whether the strong labor market of the past few years has improved the labor market connections for disadvantaged workers enough to cushion them against the next economic slowdown—especially in the face of lessened cash assistance for the nonemployed—remains an important open question.

nonmembers through the threat of unionization. But with only one-third of nonunion members desiring union representation in the mid-1980s and early 1990s, employers in most industries today probably face little threat of unionization. If workers have become more timid in their wage demands in the 1980s and 1990s, the low level of private-sector unionization would seem a prime explanation: they lack the representation to press for wage gains.

Because the decline in union membership has been rather steady and persistent, it may seem unlikely that weakened unions could have a discrete effect on wage-setting practices beginning in the 1990s. But the union movement may have passed a tipping point, with its support falling so low that employers now feel virtually free to ignore union demands. In 1998 there were only 34 strikes involving 1,000 or more workers. The 0.2 percent of work time lost to strikes in 1998 was only slightly more than 1997's record low.

What is the evidence that heightened worker insecurity is influencing labor market behavior? National data show a slight decline in job tenure and increase in displacement rate in the mid-1990s. But, as Charles Schultze writes elsewhere in this issue, the rise in job instability in the 1990s is modest compared with the public attention the issue received in the mid-1990s.

And although in surveys during the mid-1990s workers tended to voice higher-than-expected job insecurity, self-reported job insecurity has now returned to past levels for business cycle peaks. In addition, 1997 and 1998 survey data from the Institute for Social Research, which tracks families' financial security as part of its consumer confidence measure, find a sharp increase in the net fraction of families who think they are now better off financially than they were a year ago. Indeed, according to the latest 1998 data, that fraction is higher than at any time since 1965. In short, the evidence for worker anxiety causing wage restraint in the late 1990s is, at best, ambiguous.

Looking Ahead

How likely is it that the labor market changes we have investigated will have a lasting effect on employment trends in the United States? Population and labor force projections through 2006 imply that demographic shifts will exert very modest downward pressure on the unemployment rate. No evidence in the labor force projections suggests that unemployment will rise early in the next millennium because of demographic shifts. Likewise, labor market shifts brought about by innovations in the temporary help industry are likely to represent lasting structural changes in the efficiency of the labor market. The future size of the incarcerated population is difficult to predict because it depends in large part on sentence lengths—and cannot at any rate, as noted, be said to be an improvement in the labor market. Future progress in lowering unemployment will likely require new approaches to reducing the incidence of long-term unemployment and improving the labor market prospects of the less skilled and the disadvantaged. ■

Downsized?

Out?

Two decades ago, workers entering new jobs in established firms could look about and see that

Job Security and American Workers

most of their older and more tenured fellow workers had climbed a fairly steep wage ladder and appeared to enjoy a relatively high degree of job security. Over the past 20 years intense media attention and some dramatic downsizing among large companies have created a widespread perception that corporate layoffs among senior workers, at all skill levels, have seriously eroded the prospects for job security as a reward for long service.

How accurate is this perception? Has job stability significantly worsened for the average American worker? What is the cost of layoffs to workers with substantial job tenure, and have these costs been rising?

Much of the media reporting on job security has consisted of anecdotes and dramatic examples, most often involving

Charles L. Schultze is senior fellow emeritus in the Brookings Economic Studies program and holds the John C. and Nancy D. Whitehead Chair.

ECONOMIC SPIN...
Job creation outpaces layoffs

Forced to Retire
The Merge and Downsizing

Watch Out for Downsizing
RETIRED WORKERS MAY THINK

As Layoffs Loom, Loyalties Are Divided
The Merge and Downsizing

The Merge and Downsizing
The Merge and Downsizing

Unemployment Rates
1997: 22.37%
1998: 32.6%

Source: Challenge

By Charles L. Schultze

large manufacturing companies. In the search for statistical evidence about job security, researchers have spent much time and ingenuity teasing out reliable evidence from available survey data. Careful balancing of that evidence does suggest that job attachment has fallen. Moreover, for any given level of unemployment, the risk of job loss facing tenured workers has drifted up, but much less than often depicted by the media. Wage losses suffered by reemployed displaced workers with substantial tenure in their old jobs are, however, quite large.

And the sharp slowdown in the growth of real wages that occurred after 1973 made it harder for such workers to recoup their earlier living standards.

Media Hype

For more than a decade, the media have reported major downsizings and permanent layoffs in such familiar U.S. corporate giants as AT&T, GM, and Boeing. Newspapers have heralded the demise of “lifetime” jobs and a sea change in the relationship of corporations and their long-service employees. Yet the nation’s economy has been booming. Employment and output have been rising sharply and unemployment has hit record lows. How can this be?

At least some of the apparent paradox can, in fact, be explained. As overall employment has been growing rapidly, employment in manufacturing has been falling, especially in the largest, most visible, firms. Even within nonmanufacturing industries, where employment has grown on average, it has shrunk in a number of the largest firms. And large firms, especially in manufacturing, often have above-average wages. Workers from such firms who lose jobs often suffer especially large wage losses even when reemployed, because many of them do not find new jobs in firms paying similar wages. Downsizings in large premium-wage firms have thus drawn media attention and public notice, even as employment has expanded strongly elsewhere.

In short, the incidence of job losses over the past decade seems to have been disproportionately large precisely where the job losses would receive the most attention: among a relatively few large firms paying premium wages. That public perceptions about rising job insecurity and layoffs may have been exaggerated, however, does not itself mean that the phenomenon doesn’t exist.

Job Tenure

The Census Bureau periodically asks households participating in its monthly Current Population Survey (CPS) how long each worker in the household has been with the same employer. Changes in average job tenure among American workers do not themselves permit conclusions about job security. A decline in average tenure could reflect an increase in the frequency and extent to which workers voluntarily quit their jobs. Nevertheless, observing what has happened to job tenure can be a useful first step in an inquiry about job security.

According to data collected every four or five years by the CPS supplement, median job tenure for men fell quite substantially from 1963 to 1981—from 5.7 years to 4.0 years. Much of that decline, however, was due to the baby boomers’ entry into the labor force. Sharp growth in the share of young workers—who change jobs much more often than do older workers—pushed down the median tenure for the workforce as a whole. When the influence of demographic change is taken into account, tenure fell much less. It fell moderately for the 25–54 year age group as a whole and was roughly stable for other age groups.

Because the wording of the tenure question in the CPS was changed in 1983, we don’t know what happened to average tenure between 1981 and 1983. But we can trace the changes thereafter. From 1983 to 1998, median job tenure for men as a whole fell just a little, from 4.1 years to 3.8 years. But broken down by age, the picture is different. While the median tenure of the two youngest age groups fell only slightly, the tenure of older men fell substantially. Some of the decline in the 55–64 group—from 15.3 years to 11.2 years—undoubtedly reflects the continuing trend to earlier retirement, but the reductions in average tenure among the 35–44 year age group (from 7.3 years to 5.5 years) and among the 45–54 year age group (12.8 to 9.4 years) are quite large. The situation here is a reversal of that before 1981: the widespread decline in average male tenure between 1983 and 1998 is masked by the aging of the baby boomers, which decreased the relative importance of younger and low-tenured age groups. When that demographic change is taken into account, tenure fell rather sharply. Middle-aged and older men, for whatever reason, are not staying as long with their employers as they once did.

Worker Displacement

Based on responses collected in another special supplement to the CPS, the Bureau of Labor Statistics periodically publishes data on the number of “displaced workers”—workers who have been involuntarily and permanently laid off from their jobs at any time over the past three years because of plant closings, downsizing, or insufficient work.

Figure 1 graphs the BLS tabulations of displacement among long-tenured workers (those with tenure of three or more years) age 20 and up. Because some workers who report being “permanently” displaced during the year just before the survey are later rehired by the same firm, the figure includes only those workers who report being displaced during the second and third years before the survey. The rate of worker displacement equals the total number of long-tenured workers dis-

Since the early 1980s, the rate of displacement for white-collar workers



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placed during those two years as a percentage of the average number of long-tenured workers who were employed over the same period. (The annual rate of displacement can be calculated by dividing the numbers by 2.)

Even though the displacement rate data in figure 1 do not include temporary layoffs, the incidence of plant closings and downsizing clearly rises and falls with swings in the overall economy. The raw, *unadjusted*, displacement rate peaked sharply during the recessions of 1981–82 and 1991 and fell in the subsequent recoveries. But notice that the displacement rate in the 1991–92 period was as high as it was in 1981–82, even though unemployment was lower (7.2 percent vs. 8.7 percent), and the recent decline in the rate didn't bring it fully down to its level in 1987–88.

We need to remove the effects on displacement rates coming from swings in overall economic conditions to judge whether

has
risen
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to that
for
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workers.

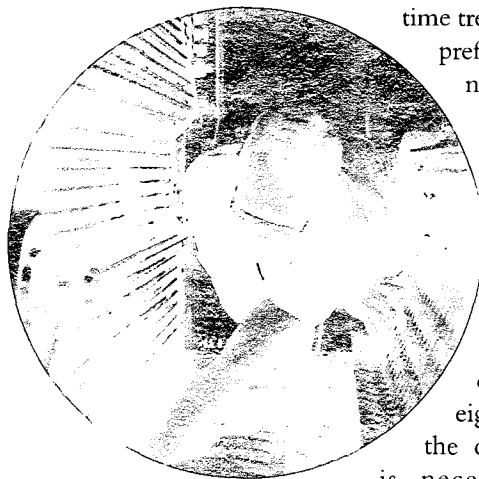
structural changes in employer-employee relationships have been producing changes in job security for tenured workers. Because we have seen large changes in the behavior of the labor market in recent years, it is not a straightforward matter to estimate the effect of business cycles on the rate of job loss. Alternative ways of estimating cyclical effects can produce different conclusions about whether there has been a long-term rise in displacements. The adjustment shown in figure 1, which measures cyclical changes by swings in the overall unemployment rate in an equation

allowing for the presence of a time trend, seems the most preferable of the alternatives. That ad-

justed rate is an estimate of what the displacement rate would have been had unemployment remained constant at 6 percent. (Because we have only eight periods of data, the cyclical adjustment

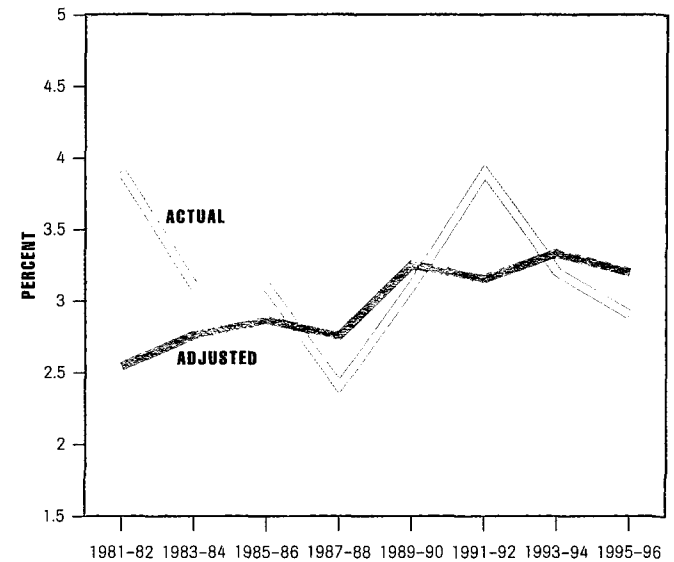
is necessarily a rough approximation.) The adjusted rate

rose during the period—for any given level of unemployment, job loss became higher than it used to be. But by 1995–96 economic prosperity and the drop in unemployment pulled the actual displacement rate in the latest survey down below the adjusted rate, to a point still above the 1987–88 actual rate but below any others since the surveys began.



LLOYD WOLF

FIGURE 1.
Displacement Rates for Workers,
1981–82 to 1995–96



Note: Displacement rates are for workers age 20 and up with three or more years tenure. The rate is the ratio of the total number displaced during the second and third years before the survey to the average employment for the relevant age and tenure group for those years.

Some people have suggested that increased worker fears about job insecurity in the 1990s have helped hold down wage growth and inflation. But the rise in the adjusted annual rate of displacement from the 1980s to the 1990s does not seem at all large enough to have been a major contributor to the wage moderation.

More White-collar Displacement

Since 1981 the cyclically adjusted displacement rate has increased for white-collar workers but not for blue-collar workers. During 1981–82 the adjusted rate for white-collar workers was 33 percent of the blue-collar rate. Thereafter the white-collar rate rose while the blue-collar rate edged down, until in 1991–92 the white-collar rate was 80 percent of the blue-collar rate. Since then the ratio has remained at about that level, far above what it was at the beginning of the 1980s. This fact may help explain the vivid public perceptions and media publicity about layoffs in recent years.

How Large Are the Wage Losses from Layoffs?

To the extent that workers gradually acquire general skills that are widely applicable in many firms and industries, their productivity and their wage will tend to rise with experience, whether in one firm or many. If laid off through no fault of their own, they will be able to transfer their skills to

other employers and command commensurate wages. But some components of the wages paid to employees with long tenure at a firm—those arising, for example, from firm-specific skills such as familiarity with the procedures and technological characteristics of a firm—cannot be transferred: laid-off workers will thus suffer a wage loss compared with their earning in prior employment. Some previously full-time workers also suffer additional losses because, at least initially, they find reemployment only at part-time jobs.

Table 1, drawn from the 1996 and 1998 CPS displaced worker surveys, shows the loss in weekly earnings suffered by workers (age 20 to 64) displaced from full-time wage and salary jobs in private nonfarm industry, who had found work by the time of the survey. (As in figure 1, only data for layoffs reported for the first two years covered by each survey are included.) For comparability, all earnings levels were adjusted by an economywide index of wages and salaries to the date of the 1998 survey (February 1998). Because the earnings of workers in troubled firms that experience large-scale layoffs often do not keep pace with wages elsewhere in the economy, the losses shown in the table should be seen as those suffered by reemployed displaced workers relative to the earnings of similar workers at firms elsewhere in the economy. This measure does not count losses during periods of unemployment (or any seniority increments forgone because of layoff).

As the table shows, earnings losses for reemployed workers with long-tenure jobs were quite substantial. Some 17 percent of the previously full-time wage and salary workers were reemployed in part-time or self-employment jobs.

Not surprisingly, their earnings losses were very much larger than were the losses of those who found full-time regular jobs.

The share of displaced workers with long tenure is less than proportional to their representation in the workforce. Thus, displaced workers with 11 or more years of tenure made up 24 percent of the workforce but only 15 percent of displaced workers. Moreover, compared with layoffs among other workers, those among workers with long tenure were somewhat more likely to be concentrated in those situations (plant closings) where employers have little discretion about whom to let go. The accumulation of substantial tenure with a firm still appears to carry some degree of job security, at least relative to more junior workers.

So far my focus has been on the immediate loss in annual wages suffered by reemployed displaced workers. Under normal circumstances, however, displaced workers who are reemployed can expect their wage with the new firm to grow as their tenure at the new firm begins to rise. Many, however, remain permanently well below the earnings path of similar workers elsewhere in the economy who are not displaced.

One well-known study collected data from 1974 through 1986 on the earnings of a large group of Pennsylvania workers with six or more years tenure, including a number who had been displaced in plant closings or mass layoffs between 1980 and 1986. The earnings data were available for a number of years before and up to six years after displacement. Extrapolating from these data, the authors, Louis Jacobson, Robert LaLonde, and Daniel Sullivan, estimated that over the years until

The slowdown in productivity and real wage growth since 1973 means that it takes displaced workers longer to recoup their wage losses once they are re-employed.

TABLE 1.
Earnings Loss among Reemployed
Displaced Workers by Years of Tenure on Old Jobs, 1993–96

	YEARS OF TENURE ON OLD JOB				AVERAGE	
	0-5	6-10	11-15	16+	ALL TENURES	6 YEARS OR MORE
ALL REEMPLOYED WORKERS						
Percent wage loss in new job	8	18	29	39	14	27
Percent of displaced workers	71	15	6	8	100	29
Percent due to plant closing	39	46	49	51	42	48
WORKERS REEMPLOYED IN FULL-TIME WAGE AND SALARY JOBS						
Percent wage loss in new job	2	8	21	28	6	17

See text for source.

retirement, this group of reemployed displaced workers would, on average, suffer a large cumulative loss relative to the earnings of nondisplaced workers. Adjusted to reflect mid-1999 wage rates, that loss would amount in present-value terms to approximately \$120,000. This estimate was dominated by the experience of workers displaced in the recession years of the early 1980s, a fact that may have led to larger than normal losses during the first few years on the new job. Nevertheless the lifetime earnings losses from displacement for long-tenured workers are clearly very substantial.

Are Wage Losses Growing?

Although I cannot find evidence suggesting that when allowance is made for the level of the unemployment rate, the size of the initial wage losses suffered by the average displaced worker has risen over the past 15 years, it can be asserted with some confidence that the slowdown in aggregate productivity and real wage growth after 1973 worsened the absolute economic losses from displacement.

As reemployed displaced workers accumulate experience and tenure with their new firm, their wages rise and the absolute size of their loss in living standards begins to fall. If real wages are also growing economywide, their wages will rise still more rapidly. Before 1973, economy-wide productivity and real wage gains averaged a little over 2½ percent a year. A wage loss of, say, 20 percent would be recouped in about nine years from that source alone. (Other workers would also have been getting the benefit of the real wage growth, so the productivity gain would not have improved the relative position of the formerly displaced worker.)

After 1973, productivity growth fell to an average of 1.1 percent a year, and between 1973 and 1996, real wages increased very little. Reemployed workers with regular full-time jobs could still benefit from the accumulation of general and firm-specific human capital in their new jobs, but they recouped their wage losses far more slowly than was possible earlier. Even if the incidence of job loss were no larger than it once was, the consequences for a worker's living standards are far longer-lasting.

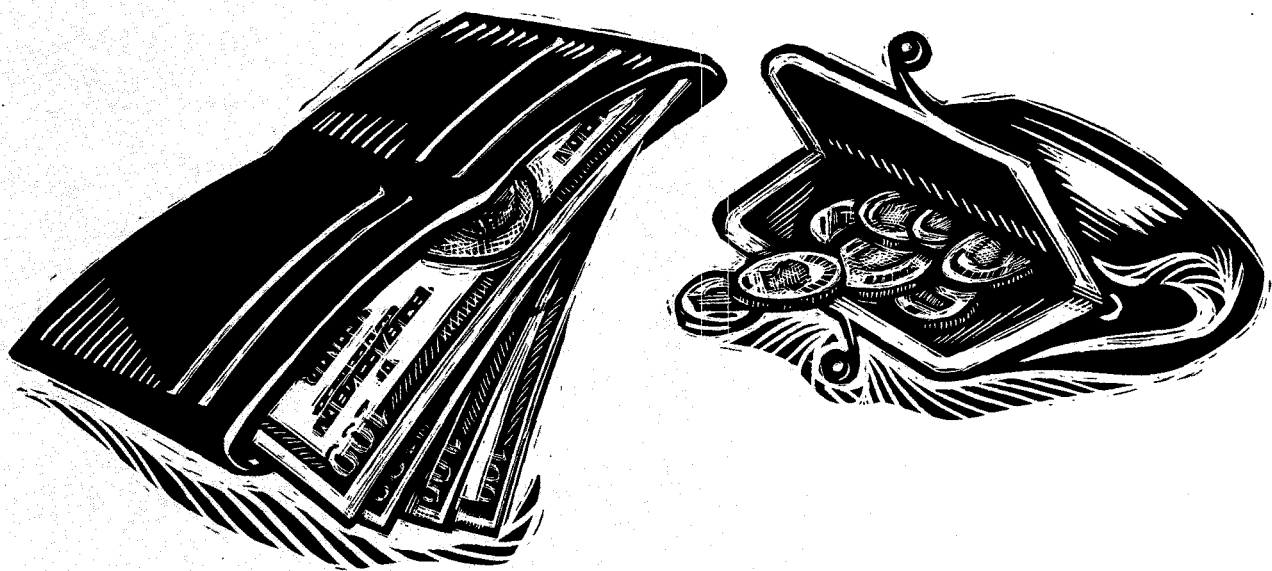
Summing Up

The evidence does point to some erosion in job attachment and an updrift in the frequency of permanent layoffs among senior workers at any given overall level of unemployment. But the unfavorable impact of these developments on job security is much less dramatic than media reporting has often suggested. On the other hand, while earnings losses suffered by displaced workers may not have grown over the past several decades, the losses are typically quite large for senior workers, and the post-1973 slowdown in productivity growth and real wage gains substantially reduced their ability to catch up to their earlier living standards. ■



Winners and Losers The Era of Inequality Continues

By Sheldon Danziger and Deborah Reed



STEPHANIE SHIELDHOUSE

Income inequality in the United States has grown substantially in the past quarter-century. Even the long ongoing economic recovery of the 1990s has done little to stem the tide. In the near future, market forces are unlikely to alleviate the hardship for low-income families who have borne the brunt of economic changes. Several public policy reforms, however, could raise the living standards of low-income families and workers.

A Quarter-Century of Growing Inequality

According to Census Bureau statistics, U.S. family income inequality (by numerous summary measures) has climbed almost continuously from a postwar low in the late 1960s. It has been higher during the 1990s than in any decade since the end of World War II. Most industrialized nations have also experienced growing income inequality, but in the United States, where the existing income disparity was greater, the rise has been more rapid. The difference, primarily, is that other countries have been more effective in countering the increased inequality generated by market forces through labor market and tax and transfer policies.

One way to measure inequality is by the relative income gap between the upper and lower “middle class.” Figure 1 shows a near-steady rise in the ratio of family income at the 75th percentile to that at the 25th percentile—the “75–25” ratio—from 1973 to 1997. In 1973, an upper-middle-income family had 2.4 times the income of a lower-middle-income family. The ratio increased to a peak of 3.1 in 1993, falling only slightly—to 3.0—by 1997.

During the 1970s, inequality rose because the income of families in the upper middle of the distribution grew faster than the income of those in the lower middle. Between 1973 and 1979, income at the 75th percentile grew 9 percent, from \$64,200 to \$70,000, while income at the 25th percentile grew 4.5 percent, from \$26,300 to \$27,500. But during the 1980s and 1990s, incomes for families at the upper middle rose while incomes for those at the lower middle fell. By 1997, family income at the 75th percentile had grown to \$80,500 while income at the 25th percentile had fallen to \$26,900 (incomes in 1998 dollars, adjusted to represent a family of four).

At the extremes of the distribution, family income fell at the bottom and grew at the top over the past quarter-century. Between 1973 and 1997 the income of families at the 10th percentile fell 7 percent, while income at the 90th percentile grew 38 percent (see figure 2). In fact, inequality increased throughout the distribution, as the size of each bar in figure 2 increases from the lowest- through the median to the highest-income families.

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Changes in inequality can also be evaluated by comparing the share of people who are poor—those living in families below the poverty line—with the share who are “rich”—those living in families with incomes more than seven times the poverty line (about \$105,000 for a family of four in 1997 using an alternative price index). Between 1973 and 1997, the share of people who were poor increased 1.2 percentage point to 11.8 percent while the share of those who were rich

FIGURE 1.
Ratios of Family Income and Male Weekly Wages of the Upper-middle Class to Those of the Lower-middle Class

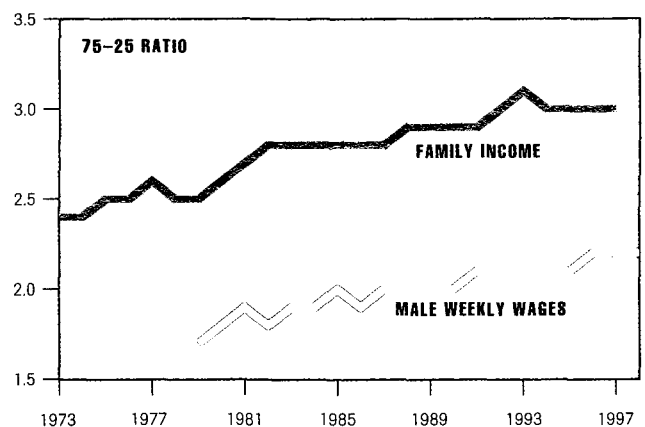
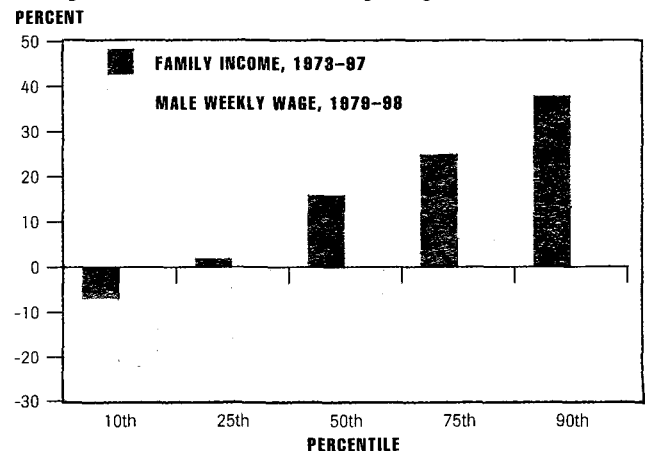


FIGURE 2.
Percentage Change in Real Family Income and Male Weekly Wages



increased 8.1 percentage points to 14.3 percent—yet one more indication that economic growth has raised incomes at the top of the distribution while allowing absolute incomes at the bottom to stagnate or fall.

Despite the Economic Boom, the Gap Remains

Although the robust economic recovery of the 1990s has produced the lowest unemployment and inflation rates in 30 years and has lifted living standards across the income distribution, families below the median have not yet fully recovered from the income stagnation and recessions of the early 1980s and early 1990s. Family income in the lower middle of the distribution remains a few percentage points below its 1989 and 1979 peaks, whereas that in the upper middle has increased a few percentage points since 1989 and 15 percent since 1979. As figure 1 shows, family income inequality fell slightly as the economy recovered from the recession of the early 1990s. But as of 1997, the 75–25 ratio was still higher than it was in 1973, 1979, and 1989, the last three business cycle peaks.

Changes in the distribution of male earnings—the largest single component of family income—account for much of the increased family income inequality. Thanks to the current economic expansion, the wages of men at the bottom of the distribution grew between 1996 and 1998, but weekly wages for full-time male workers at the 10th and 25th percentiles, \$300 and \$432 respectively, remain more than 6 percent below their 1989 business cycle peak and more than 15 percent below the 1979 peak. The 75–25 ratio for men's weekly wages was just below 2.2 in 1998, slightly under its 1997 peak, but well above the 1979 and 1989 peaks (1.7 and 2.0, respectively; see figure 1).

Male earnings inequality rose during 1979–97 because real earnings fell for workers at the median and below and grew for those at the top of the distribution. Figure 2 shows a decline in men's earnings of 22 percent at the 10th percentile, 16 percent at the 25th percentile, and 7 percent at the median. Over the same period, men's earnings grew 6 percent at the 75th percentile and 13 percent at the 90th percentile.

Why Is Inequality Increasing?

Most economists agree that the main source of growing earnings inequality is the rising value of worker skill. In 1979, for example, the median full-time weekly wage for men with college degrees was 29 percent higher than that for men with high school diplomas only. By 1998, college graduates had a 68 percent edge. During 1979–98, real wages increased 8 percent for male college graduates but fell 18 percent for high school graduates. For women, the weekly wage gap between college and high school graduates increased from 43 percent in 1979 to 79 percent in 1998. The work experience differential increased as well, with earnings of workers with substantial labor market experience growing relative to those of new labor market entrants.

There is some disagreement over the relative importance of various causes of the rising value of skill. Labor-saving technological changes have simultaneously increased the demand for skilled workers who can run sophisticated equipment and

reduced the demand for less-skilled workers, many of whom have been displaced by automation. Global competition has increased worldwide demand for the goods and services produced by skilled workers in high-tech industries and financial services. Lower-skilled workers increasingly compete with low-wage production workers in developing countries. Immigration has increased the size of the low-wage workforce and competition for low-skilled jobs. Institutional changes, such as the decline in the real value of the minimum wage and shrinking unionization rates, also moved the economy in the direction of higher earnings inequality.

Developments other than rising earnings inequality also widened the family income gap. In particular, changes in family structure, especially the growing share of female-headed households, increased the number of low-income families. A growing tendency for high-earning men to be married to high-earning women further separates the incomes of dual-earning couples from those of female-headed households.

Implications for the Future

Because growing income inequality arises primarily from long-term structural changes in the labor market that are unlikely to be reversed, U.S. income inequality is likely to remain high in the coming decade.

Even an extension of the current economic boom cannot be expected to close the family income gap any time soon. As figure 1 shows, the greatest single year of improvement in narrowing the family income gap was 1993–94. But the income gap in 1997 was still so large that *nine more years* of the unparalleled progress of 1993–94 would be required to return family income inequality to 1979 levels, almost twelve more such years to return it to 1973 levels.

Because the economic returns to skills have increased so much, the labor market now provides incentives for workers and young people to upgrade their skills through education and training. Indeed, the share of high school graduates entering college has already grown in the past few years. But though the resulting growth in the supply of skilled workers may eventually reduce labor market inequality, the adjustment will take years—years during which the wages of less-skilled workers are likely to remain low.

Nor will all workers respond equally to the incentives to improve their skills. Generally speaking, younger Americans are much more likely to undertake substantial investments in education or training programs than are prime-age workers who have been hurt by changes in the labor markets over the past quarter-century and who have relatively few years of work left before retirement. In addition, because of pervasive inequalities in school quality and access, children from the poorest families and from racial and ethnic minorities who are concentrated in the inner cities are likely to respond less than average to the incentives.

Policy Directions

We are concerned about increased inequality over the past quarter-century because of its effects on both the absolute and

relative well-being of low-income families and workers. Even without a decline in income for those at the bottom, we care about rising inequality because, as Adam Smith noted, the minimum acceptable standard of living tends to be higher the richer the society. Moreover, according to recent Nobel laureate Amartya Sen, the absolute well-being of the poor in terms of their ability to "participate in the standard activities of the community" depends on their relative well-being in terms of resources.

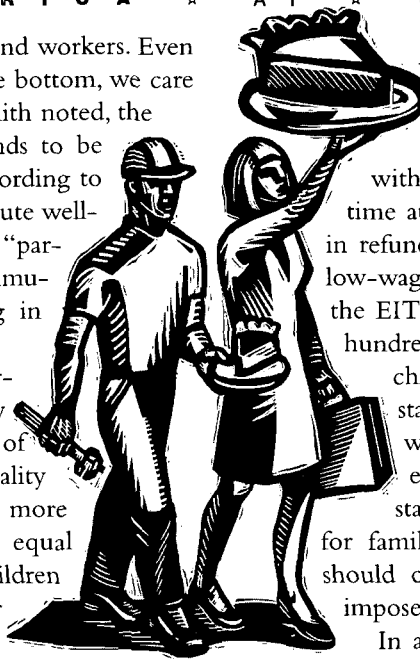
Increases in inequality over the past quarter-century are likely to have made equality of opportunity harder to attain. The children of the poor are increasingly subject to lower-quality education, lower-quality health care, and more dangerous communities. Concerns about equal opportunity are particularly relevant for children from female-headed households and for those who are racial and ethnic minorities because they are far more likely to grow up in poor families.

Many of the economic forces that have contributed to rising income inequality have also brought positive changes in our economy. Technological changes and increased globalization raise the average standard of living by bringing new goods to consumers and producers and by reducing their prices. The rising value of skill provides incentives for people to upgrade their own skills, which can be financially and personally rewarding. Even if it were possible to slow technological changes or adopt protective barriers to trade, we see no reason to attempt to lower inequality by doing so.

The United States has pursued policies to promote free trade and technological advancement in the interest of growth and efficiency; in doing so it has produced winners and losers. Government policies should therefore help reduce the resulting inequalities by aiding the low-income families and less-skilled workers who have borne the brunt of labor market changes.

Reasoned policy in this area must take into account two realities. First, the recent welfare reform experience has shown that the public favors policies that promote work. Welfare reform has dramatically reduced cash assistance for people who are capable of working, but it has offered expanded wage and child care subsidies. Second, education and well-designed training programs can improve the earnings of workers and promote economic opportunity in the long run. These policies, however, are unlikely to substantially improve the well-being of low-income workers in the coming decade. For the short term, policymakers should expand work-oriented antipoverty policies that raise the incomes of the least-skilled workers.

For people who are able to find jobs, the key elements of support are wage supplements and refundable child care tax credits. The Earned Income Tax Credit, substantially expanded in 1993, has done much to offset the decline in real wages for workers at the bottom of the earnings distribution who work



year-round and who have children. Almost all low-income families with children are now eligible for substantial credits from the EITC. For example, a single mother with two children who works year-round, full-time at the minimum wage receives about \$3,600 in refundable tax credits. But only a small share of low-wage workers who do not have children receive the EITC, and their maximum credit is only a few hundred dollars. Raising substantially the EITC for childless workers would increase their living standards without taking them through the welfare system and would also make the federal income tax more progressive. Several states have already adopted their own EITCs for families with children, something other states should consider, especially those that continue to impose income taxes on the working poor.

In addition, even though the employment rate and earnings of single mothers have increased in the past five years, many single mothers, especially former welfare recipients, with young children are hard pressed to work full-time, year-round because a large portion of their earnings must go to child care. Increasing public subsidies for child care would be particularly beneficial for this group. The Dependent Care Credit (DCC) provides tax relief for families with children, but it is a nonrefundable credit and so benefits only families with positive income tax liabilities. Making the DCC refundable would raise the disposable income of single mothers and other low-income working families who spend substantial sums on child care but do not owe federal income tax. It too would make the federal income tax more progressive.

Finding a job has become more difficult for less-skilled workers over the past quarter-century. In mid-1999, even with the lowest unemployment rate in 30 years, many less-skilled workers are unable to find work. For those who want to work but are unable to find regular employment, transitional public service "jobs of last resort" at wages just below the minimum can provide the basis for a work-oriented safety net. Such "jobs of last resort" are more important than ever now that we have "ended welfare as we know it." During the next recession, many former welfare recipients will find themselves out of work and without recourse to cash assistance because of time limits, sanctions, and other aspects of welfare reform.

Looking Ahead

The good news is that the current economic recovery seems to have slowed the quarter-century trend toward rising income and earnings inequality. The bad news is that inequality is unlikely to return to the level of the late 1970s any time soon, much less to the lower levels of the late 1960s and early 1970s. As this era of inequality continues to unfold, work-oriented policy reforms could, at relatively modest cost, greatly benefit those workers and families most disadvantaged by the structural economic changes that have boosted the fortunes of the rich. ■

Squeezed for Time?

American Inequality and the Shortage of Leisure

Most informed observers recognize that American inequality has worsened over the past generation. The gulf separating high-income families from families in the middle class and on the bottom has widened noticeably, especially since 1979.

Many middle-class Americans also have a nagging sense that they are running harder and faster merely to stay in the same place, that the time it takes to earn a decent living, care for a home, and rear their children has increased, leaving them with less leisure time.

Public polls regularly pick up this perception. In 1973 the median response to a Harris poll question about the time needed to earn a living, attend school, and care for a home and family was 40.6 hours a week. By 1999 the median estimate had jumped to 50.2 hours. Asked how much free time was left each week for relaxation, sports, hobbies, entertainment, and

By Gary Burtless

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socializing, respondents estimated 26.2 hours in 1973, but just 19.8 hours in 1999. And a 1998 Gallup poll found Americans expressing record or near-record satisfaction in most areas of life, with two conspicuous exceptions. Respondents expressed sharply lower satisfaction with their jobs and with the amount of leisure than similar respondents did in the 1960s.

The perception that leisure time is disappearing is reinforced by popular studies, such as Juliet B. Schor's celebrated *The Overworked American: The Unexpected Decline of Leisure*. Schor's book documents a two-decade surge in work hours, which she reckons added 163 hours a year—almost one month a year in a full-time job—to the paid working time of labor force participants between 1969 and 1987.

Until recently, few scholars have investigated the link between shrinking leisure time and the shifting distribution of incomes. The connection, however, can have important welfare consequences. If people at the bottom of the income distribution have lost out on leisure, the resulting time squeeze compounds their losses from declining hourly pay and scaled-back public assistance. If the affluent have lost more free time, we have a partial explanation for the widening income gap: well-to-do breadwinners have sacrificed free time to boost their spendable incomes.

More Free Time or Less?

The first question we should ask must be: has leisure time actually declined? Is Americans' perception of a time squeeze based on hard evidence about the trend in hours that people actually work?

Some scholars flatly reject Schor's finding that leisure time has shrunk. Relying on detailed time diaries kept by adult respondents in 1965, 1975, and 1985, sociologist John B. Robinson finds that average free time actually *increased* 4.8 hours a week, or nearly one-seventh, between 1965 and 1985. In his book with co-author Geoffrey Godbey, *Time for Life*, Robinson defines free time as time available after people have completed paid work, family and household chores, and personal care (including sleep). The 1965–85 gain in free time was a result of declines in both paid work hours and time devoted to housework and child care—but in different proportions for men and women. Women devoted more time to paid work, less time to housework and child care; men gave more time to housework, less to paid work. The net gain in free time was similar for the two sexes, though slightly larger for women.

While the time diary findings are intriguing, some are hard to square with other evidence about the hours Americans spend at work. The most comprehensive such survey is the Bureau of Labor Statistics' Current Population Survey, monthly interviews with members of about 50,000 households, used primarily to measure unemployment. For the population and period Robinson examined, the CPS shows small reductions in the weekly work effort of men and women at work in a given week but, thanks to a large jump in the share of women in paid work, a sizable increase in the share of adults

who hold jobs. Thus, average hours at work among 18–64 year-old adults increased significantly.

Robinson's findings can be reconciled with the CPS evidence if time actually spent on the job is reported more accurately in time diaries than in the CPS interviews. Robinson himself suggests that the overstatement of working hours in CPS-type interviews increased more than fivefold from 1965 to 1985, jumping from less than 2 hours a week to more than 8 hours a week among 18–64 year-old workers. This leap in misreporting seems too large to be accepted at face value. At least part of the growing difference between the time diary and CPS hours estimates must be due to flaws in time diary sample or data. Unfortunately, treating Robinson's time diary estimates skeptically leaves us with little hard evidence to gauge the trend in hours devoted to unpaid child care and work around the house. Neither the BLS nor the Census Bureau asks people how much time they devote to activities other than paid work and commuting.

Trends in Hours Worked

Whatever their defects, the CPS interviews highlight three major changes in work patterns and the use of adults' time over the past generation. Women have joined the paid work force in

Polls find that Americans express sharply lower satisfaction with the amount of their leisure today than they did during the 1960s.

record numbers; men have retired at a younger age; and women have borne fewer children. Figure 1 shows the effects of the first two trends. The lighter bars show average hours Americans spent on the job during the second week of March 1968; the darker bars, average hours exactly 30 years later in March 1998. The weekly average is the total hours of work during the week divided by the number of women or men in the indicated age group, including people who do not work.

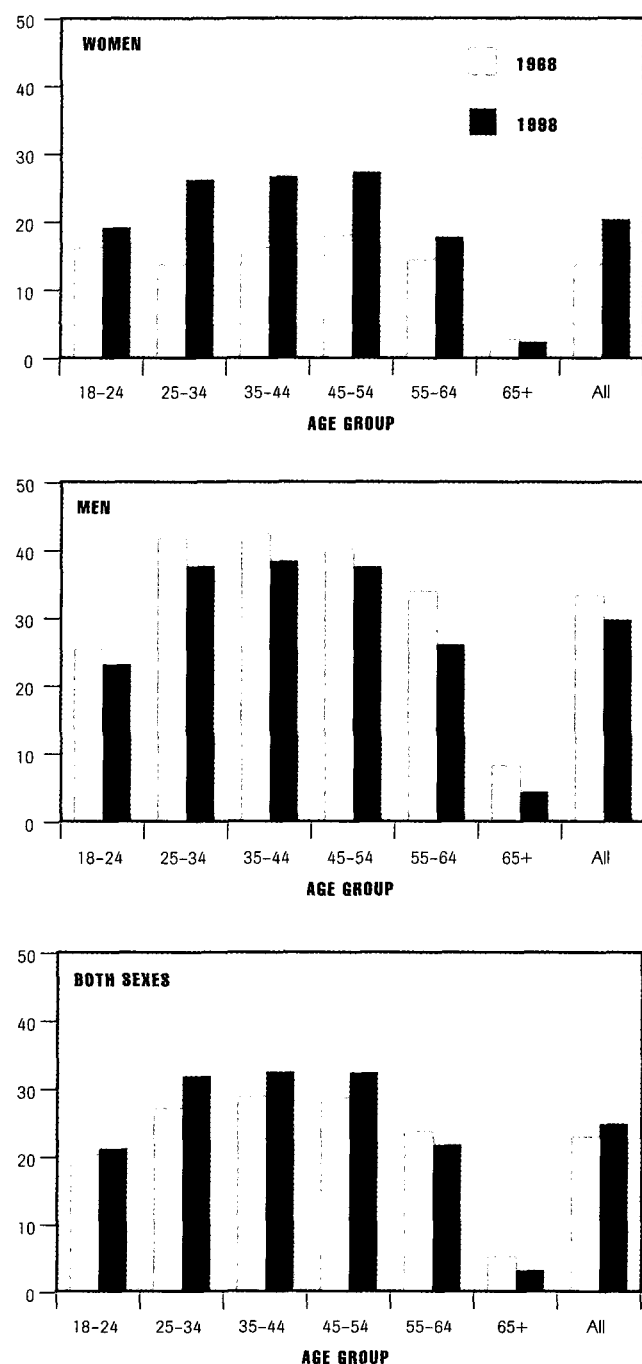
As the top panel shows, women worked longer hours in 1998 than they did in 1968 at every age up through 65. Averaging across all ages, women worked half again as many hours in March 1998 as they did in March 1968 (20.3 hours a week, as against 13.6). The rise was due to a 45 percent jump in the fraction of women at work and a 3 percent increase in the average weekly work effort of women holding jobs. The biggest proportional increase in women's employment occurred among the prime-aged groups, those between ages 25 and 54—precisely when women are most likely to be looking after children.

The middle panel of figure 1 shows a dip in men's paid work, mostly as a result of sinking employment, especially among men past age 54. Across all ages the male employment

FIGURE 1.

Average Weekly Hours of Paid Work by Age Group, 1968 and 1998

AVERAGE WEEKLY HOURS AT WORK



Source: Author's tabulations of March 1968 and March 1998 CPS files.

Note: Weekly hours reflect average reported work hours for the March reference week among all adults in age group, including adults not currently employed.

rate slid 6 percentage points between 1968 and 1998, but it fell 15 percentage points among men between 55 and 64 and 9 points among men past 64. Weekly hours of men with a job

also edged down, but the drop was inconsequential except among men under 25 and older than 64.

When these shifts in male and female work patterns are combined (bottom panel of figure 1), hours spent on the job increased for people aged 18 to 54 and declined for people past age 54. Because people older than 54 are also the least likely to be raising children, it is apparent that older Americans enjoyed much more free time in 1998 than they did in 1968. For prime-aged adults, however, free time may be shrinking. Their employment rate jumped 11 percentage points between 1968 and 1998, boosting the average weekly time spent in jobs from 28 hours to 32 hours—or five extra 40-hour work weeks a year.

Caring for Children

If working-age Americans now spend more time on the job, they spend less time raising children, because there are fewer children to raise. In 1968 there were almost 80 children under 18 for every 100 adults between 18 and 54. By 1998 there were just 50 children for every 100 adults in that age group. Almost 70 percent of women between 25 and 54 lived with dependent children in 1968; only 55 percent did so in 1998.

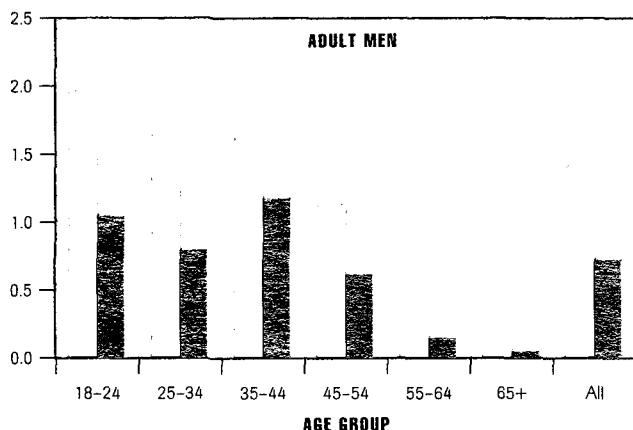
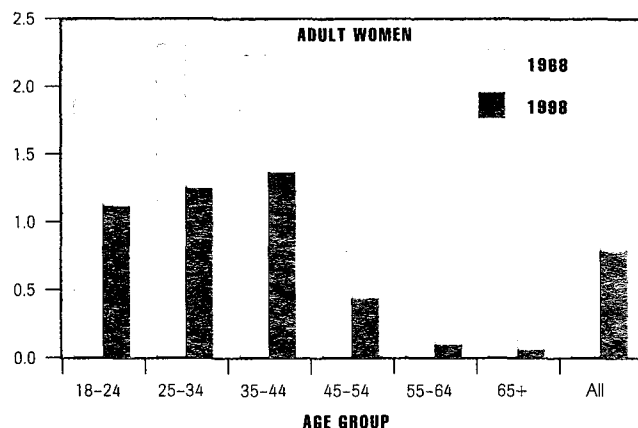
Figure 2 shows trends in the presence of children in families with adults of different ages. Again, the lighter bars refer to March 1968; the darker bars, to March 1998. The top panel shows the sharp decline of children under 18 in families with women. Families with women between 25 and 34, for example, averaged 2.3 children in 1968, but only 1.2 children in 1998. To be sure, women who have children are nowadays more likely to combine child rearing with employment. Many thus face heavier time demands than did most mothers in their parents' generation. But 37 percent of women between the ages of 25 and 34 live alone or in a family without children today; just 16 percent did so in 1968.

The trend among men is even more striking (lower panel of figure 2). Families with 25–54 year-old men averaged 1.7 children in 1968, but just 0.9 children in 1998. In 1968 the share of those men living alone or in a family without children was one-third; by 1998 it was 53 percent. Even though men today take more responsibility for household chores and child care, fewer men live in households containing children—partly because they have fewer children, partly because children are less likely to be reared in families where both a mother and a father are present. The latter trend obviously increases the time burden on custodial parents, but it eases burdens on parents who do not live with their children.

Much of the concern about a possible time shortage focuses on families with children. In her well-regarded *The Second Shift*, for example, Arlie Hochschild examines how parents reconcile the demands of work and family. Among the couples she interviewed were many who worked in full-time jobs and had children under age 6. But though this pattern is much more common today than it was in the 1960s, it is still far from the norm. Only about a third of married mothers with children under 6 work full-time year-round; about a third do not work at all.

FIGURE 2.
Number of Related Children under Age 18
in Family, 1968 and 1998

AVERAGE NUMBER OF CHILDREN IN FAMILY



Source: Author's tabulations of March 1968 and March 1998 CPS files.

Note: Families containing adults include unrelated adults. Thus all adults in each age group, including those who do not live in Census-defined families, are included in the tabulations.

The President's Council of Economic Advisors recently issued a report, *Families and the Labor Market, 1969-99*, analyzing trends in income and parental hours of work and the implications of these trends for family well-being. Although its findings suggest that parents in the late 1990s have less free time than they did in the 1960s, the Council's analysis focuses solely on families with children, so it sheds little light on the broader question of whether Americans in general are afflicted by a worsening time shortage.

The Council's (and the public's) concern with the situation of families with children is certainly appropriate. But households *without* children are on the increase. Many Americans refrain from having children to increase time available for paid work and leisure. Some presumably achieve a less hectic life as a result. By focusing on families with children, we can lose sight

of the leisure gains in an important and growing part of the adult population.

The Time Squeeze Meets the Income Gap

Trends in free time have not occurred in a vacuum. Women's hourly wages have increased over the past 20 years, and wages of men with little schooling have sunk. Higher divorce rates and postponed marriage have reduced the share of adults who are married at any given time and dramatically increased the share of children reared by a single parent. All these trends helped push income inequality to a postwar high in the 1990s.

Table 1 uses information from the CPS to show the change in work effort between 1968 and 1998 among prime-aged adults, including those who do not work. The adults are ranked by quintile in the income distribution, with income based on the March CPS interviews of 1968 and 1998, adjusted for differences in family size. The top portion of the table shows average weekly hours of work among women. Not surprisingly, the time spent at work increases as we move up the income distribution. Women in the top quintile work about twice as much as women at the bottom. But the 1968-98 *increase* in hours on the job was largest among women in the middle of the distribution. Those in the second and third quintiles worked twice as much in 1998 as their counterparts did in 1968. Women in the bottom quintile had the smallest absolute and proportional gains in hours.

The middle portion of the table shows declining weekly work hours among men. For men in the bottom fifth of the income distribution, hours of work tumbled almost a third. Work effort reductions grow smaller as we move up the income ladder. In fact, men in the top of the distribution worked slightly longer hours in 1998 than high-income men did in 1968. These trends help explain the growing gap in relative incomes. Men at the bottom worked significantly less, cutting their earned incomes; men at the top worked a little more, boosting their incomes. Because men on the bottom suffered losses in hourly wage rates while men at the top

People on the bottom rungs of the financial ladder suffer a famine of good jobs rather than a time famine.

enjoyed wage gains, the shifts in hours widened an income gap that would have grown even without a change in hours.

The work effort trend for both sexes combined is displayed in the bottom portion of the table. Average hours on the job increased considerably throughout the top four quintiles, but they grew fastest in the middle quintiles. Hours of work fell 9 percent among adults in the bottom quintile. Because adults in the middle and higher quintiles were increasing their work

effort while adults at the bottom worked less, the income gap widened. People on the bottom rungs of the financial ladder suffer a famine of good jobs rather than a time famine. The loss of well-paying jobs is a serious problem for these Americans; the loss of free time is not.

Shifts over time in child care responsibilities are important in interpreting the changes in time spent in a job. Table 2 shows how child care responsibilities are distributed across income groups and how they have declined over the past three decades. In 1968, more than two-thirds of prime-aged adults lived with a related child under 18. By 1998 only about half did so. In both 1968 and 1998, adults with below-average income were more likely than high-income adults to live with related children.

Although child care responsibilities are more common for adults in the lower ranks of the income distribution, such responsibilities have declined much faster at the bottom than at the top of the income distribution. The share of adults living with children dropped 20 to 24 percentage points in the three bottom quintiles but just 4 percentage points among adults in the top. Adults in the bottom fifth thus saw sizable reductions in both the time spent in paid work and the likelihood of living with children. Adults in the middle three quintiles devoted sharply more time to paid employment but were significantly less likely to live with children under age 18. Only in the top fifth of the income distribution were adults working much longer hours while experiencing little reduction in their child care responsibilities. These high-income adults seem more stretched for time than similar adults in the past. On the other hand, their sacrifice of free time has been richly compensated: their incomes have grown about 2½ times faster than those of people in the middle of the income distribution, widening the absolute and relative income differences between high-, middle-, and low-income families.

Famine and Plenty

The time famine has not struck indiscriminately. Parents, especially mothers, nowadays have less time left over after paid employment for child care, housework, sleep, and quiet leisure than their parents did in the 1960s. But American seniors as well as younger adults who remain childless

TABLE 1.

Change in Work Effort among Prime-aged Adults, by Income Quintile, 1968–98

	AVERAGE HOURS/WEEK BY INCOME QUINTILE				
	BOTTOM	2ND	MIDDLE	4TH	TOP
WOMEN					
March 1968	11.6	12.8	14.5	18.9	22.2
March 1998	16.4	26.3	28.9	30.9	32.4
MEN					
March 1968	36.1	41.4	42.0	42.9	43.6
March 1998	24.6	36.4	39.9	42.0	44.2
BOTH SEXES					
March 1968	21.9	26.6	28.0	30.8	33.0
March 1998	19.9	31.3	34.5	36.6	38.4

Source: Same as figure 1. Prime-aged adults are those between ages 25 and 54. Income is for the previous calendar year. The income of each adult is measured as the ratio of the family's actual income to the family poverty threshold.

TABLE 2.

Change in Share of Prime-aged Adults Caring for Children, by Income Quintile, 1968–98

	PERCENT BY INCOME QUINTILE				
	BOTTOM	2ND	MIDDLE	4TH	TOP
March 1968	80	83	77	62	40
March 1998	60	59	55	46	36

Source: Same as figure 1. An adult is classified as caring for children if he or she is a member of a nuclear family with at least one related child under 18.

The main victims of the time famine are married couple families and single parents who combine full-time jobs with child rearing. Both kinds of family are more common than they were 30 years ago. Both face difficult choices reconciling lengthy hours of paid work with good care for their children. I suspect both also supply an outsized share of commentators bemoaning the time shortage. Some people

The main victims of the time famine are married couples and single parents who combine full-time jobs with child rearing.

probably enjoy more free time today than people the same age did a generation ago. Nor do adults with low incomes suffer from a shortage of free time. Their situations would improve if they could find well-paying jobs to fill some of the free time they have gained since the 1960s.

face a time squeeze because a marriage failed (or never took place), forcing the custodial parent to work and care for kids at the same time. Others feel pushed into their predicament because the wage of the male breadwinner has not kept pace with the cost of living. But we should acknowledge that many lucky couples have walked into a time vise with eyes wide open. Enticed into the job market by improving wages and interesting jobs, mothers in high-income families must squeeze more obligations into a 24-hour day. They may not think they can do it all, but many are confident they can do much more than mothers in their parents' generation. ■

By Margaret M. Blair and Douglas L. Kruse

Worker Capitalists?

Giving Employees an Ownership Stake



Employees, always considered important stakeholders in American corporations, are today emerging as a key shareholder group. Although data tracking employee share ownership over time are spotty, an abundance of individual studies and anecdotal evidence suggests that it has been expanding steadily in the past two decades.

According to surveys, about 20 percent of U.S. adults now report owning stock in the company for which they work. And the most recent Labor Department data show that employee retirement plans, including employee stock ownership plans (ESOPs) and defined-contribution pension plans, such as 401(k)s,

held nearly \$314 billion in employer stock at the end of 1994—about 5.3 percent of the estimated \$5.9 trillion in corporate equity outstanding that year. A much larger and rapidly growing share of corporate equity is also held in stock option plans. Surveys suggest that as many as a third of large corporations

now offer broad-based stock option plans to all or most of their employees. Corey Rosen, executive director of the National Center for Employee Ownership, estimates that option plans for non-management employees now have as much as \$1 trillion in them, and that, in total, at least 6–10 percent of corporate

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equity is held by, or on behalf of, non-management employees.

A 1991 study by Kruse and Joseph Blasi found that employees, either directly or through their pension or other benefit funds, owned blocks of 18 percent or more of outstanding shares in 148 large publicly traded companies—up from only one such company (Sears Roebuck) in 1974 and 27 as late as 1983. Blasi and Kruse predicted that by 2000 more than one-quarter of all publicly traded companies would have at least 15 percent of their stock in employees' hands. Indeed, anecdotal evidence suggests that many firms that have grown to substantial size since 1991, especially in retailing (Starbucks and Home Depot) and in high-tech sectors (Microsoft, Intel), compensate employees in part with stock options and are now substantially employee-owned.

What is driving these new employee compensation arrangements and share ownership patterns, and how far is the trend likely to go? Now that market capitalism has won out in the economic contest against socialism, are workers, in an ironic twist of history, turning into capitalists? And what implications, if any, does this shift have for corporate performance and employee welfare?

These questions have no simple answers. Developments in tax policy, corporate governance, and human resource management appear to be behind the shift toward employee share ownership as an employment norm. Each by itself might be limited in its effect, but together they have caused a change in the structure of share ownership—one that has probably not yet run its full course. While the U.S. economy is highly unlikely to consist of worker collectives any time soon, over time the shift may have a substantial impact on corporate performance and wealth distribution.

The Tax Push

Tax incentives favoring employee stock ownership take several forms. The 1973 Employee Retirement Income Security Act and subsequent legislation created modest tax incentives for firms that set up ESOPs, for financial institutions that loan money to firms to set up ESOPs,

and for entrepreneurs who sell their firms to their employees when they retire. Most of these tax incentives have been removed or weakened over the years, and most studies have concluded that they have had little effect on the growth of employee share ownership.

A second type of tax incentive—the special tax treatment of stock options—has probably had a significant, and still expanding, impact. One reason stock options have become such a popular way to compensate management and employees in recent years is that taxes are deferred on compensation received in that form. If employees are paid in cash or stock (rather than in options to buy the stock), they must report the value of the cash or the market value of the shares as income when they receive it. But the IRS treats stock options as if they have zero value at the time they are issued, so the employee pays no taxes, and the company records no expense on its books, until the option is exercised. Once it is, the employee pays taxes on the difference between the market value of the stock and the exercise price. If the options satisfy certain requirements, taxes on the income may be deferred and then paid only at the capital gains rate. That double tax benefit makes stock options very attractive to employees, especially when stock prices are rising.

As a matter of policy, this special tax treatment for stock options is hard to justify. It was not part of a deliberate attempt by policymakers to stimulate employee share ownership. It may also have done more to stimulate big stock option awards to senior executives than to encourage broad-based stock option plans for employees. But political support for it is now entrenched, and the continuing special tax treatment of stock options may well promote further growth in their use. The net impact on employee share ownership is less clear, however, since anecdotal evidence suggests that employees who exercise stock options often sell the shares quickly.

Corporate Governance

Two developments in corporate governance have been encouraging employee share ownership in recent years. The first

was the discovery by corporate managers in the mid-1980s that firms were less vulnerable to takeover if a substantial block of their shares was held by employees or held for them in ESOPs or other employee benefit plans. Corporate executives reasoned that both employees and employee benefit plans were stable shareholders who would not be likely to sell out to hostile “raiders,” and a study we recently completed with Joseph Blasi confirmed that reasoning:



companies with substantial employee ownership were indeed far less likely to be taken private in a leveraged buyout in the 1980s and early 1990s.

In addition, the state of Delaware (where about half of all large corporations are incorporated) took two actions during the late 1980s that strengthened the implicit takeover protection provided by employee ownership. In 1987 the state legislature required bidders who hold more than 15 percent of a company to wait three years to complete a takeover unless they acquire at least 85 percent of the target company's shares. Although employee-shareholders can vote against management and ESOP trustees can sell out to a raider, they rarely do. So if 15 percent or more of a company's shares are held in an ESOP, it is almost impossible for a hostile bidder

to acquire 85 percent. And in 1988 a Delaware court approved an ESOP hurriedly set up by Polaroid as a takeover deterrent—thereby indicating that as long as an ESOP meets certain conditions, setting one up would be considered a legitimate takeover defense.

Probably not coincidentally, many large corporations established ESOPs in the late 1980s. By 1991, Allied-Signal, Anheuser-Busch, Boise Cascade, Chevron, Cooper Tire & Rubber, Enron, Fairchild Industries, FMC, Harcourt Brace Jovanovich, Lockheed, Lowes Companies, J.C. Penney, Phillips Petroleum, and many less well-known companies all had blocks of shares totaling 15 percent or more of outstanding shares held by or on behalf of employees.

Employee share ownership has also grown through corporate restructuring in which employees received shares in their companies in exchange for wage and benefit cuts. Occasionally, complete employee-buyouts have been necessary to prevent plant closings. Such transactions, though rare in the economy as a whole, have figured prominently in the trucking, steel, and airline industries, and very recently in the paper industry. Among the most well-known are the employee buyout of Weirton Steel in 1984 and the restructurings at Northwest Airlines and TWA in 1993 and at United Airlines in 1994. At United, employees ended up with more than 50 percent of the shares, and the board was restructured to include significant union representation.

Corporate restructuring that gives employees a large block of shares to resolve labor disputes or provide takeover protection may continue, especially in unionized industries under competitive pressure to reduce labor costs. But it will probably not greatly expand employee share ownership.

Human Resources

Tax incentives and corporate governance alone do not generally provide a sustainable rationale for deliberately restructuring a firm as an “employee-owned” or even partially employee-owned firm. The final consideration

driving the trend—employee motivation and human resource management—may provide such a rationale, however, and may drive the phenomenon considerably further than it has already.

In the past 10 years or so, the business world has been substantially rethinking the relationship between large firms and their employees. Even if there was no “social contract” between large employers and their employees before the 1980s, strong business norms led both to expect that employers would hire employees who would stay with them a long time, be promoted through the ranks, earn a decent salary, and receive certain benefits such as pensions, paid vacations, and health care. During the downsizings of the late 1980s and early 1990s, however, many large, highly visible employers that had once adhered to, and even promoted, these norms retreated strongly from the commitments implicit in them. Long-time employees were laid off, and employers cut back on—and even canceled—health care benefits and converted pension plans to defined-contribution plans, thereby shifting the investment risk onto employees.

By the mid-1990s, young workers in their 20s or 30s, as well as many older workers, had come to regard a lifetime job with secure benefits as a thing of the past. Likewise, and importantly, they also abandoned the idea that they might owe their employer any loyalty. In certain sectors of the economy, such as high-tech start-ups, software firms, financial services, consulting and other business services, and retailing, job hopping has become the new employment norm. It is in precisely these sectors that the use of stock options and other equity-based compensation schemes has become most common.

Compensating employees, at least in part, with stock or stock options is thought to serve several purposes that are attractive in today’s business environment. First, it helps to align employees’ interests with those of shareholders. Second, equity-based compensation packages can easily be designed to encourage employees to stay around, even as other pressures may encourage job hopping.

Third, the equity component of employee compensation is flexible, thereby implicitly reducing the fixed-cost component of compensation expenses. And finally, as a form of non-cash compensation, stock options help start-up firms preserve cash. In fact, paying employees in stock options may help the firm bring in cash, because when the employee exercises the option, he or she must pay cash to the company to buy the stock (though at a discount to market value). Combined with a booming stock market and special tax treatment for stock options, these factors make stock options uniquely attractive to both employees and employers in growing parts of the economy.

Motivating Employees

The idea that paying employees with stock helps motivate them implies that firms in which employees are substantial shareholders should be more productive. A countervailing body of theory, however, argues that employee-controlled firms would be inefficient and that employee-owners would have perverse incentives (they might, for example, be too risk-averse) or that incentive effects would be too diluted in large firms, where the actions of any one employee are unlikely to have a direct or obvious effect on share prices. Empirical studies on the question have produced mixed results, but “meta-analyses” of more than 30 empirical studies in the past 20 years indicate that corporate performance is 4–5 percent higher on average under employee ownership. The variance around that finding is high, however, and it is clear that adopting employee ownership alone does not automatically boost performance. Employee share ownership seems to be most productive in firms that also give employees enhanced decision-making rights and authority. Indeed, a new study by Avner Ben-Ner, W. Allen Burns, Greg Dow, and Louis Putterman finds that in firms with substantial employee share ownership and employee involvement in decisionmaking, the tasks undertaken by employees tend to be quite complex. Consistent with this evidence, the sectors with a

For Further Reading

Margaret M. Blair and Thomas A. Kochan, eds., *The New Relationship: Human Capital in the American Corporation* (Brookings, 1999). See especially Blair, Kruse, and Joseph Blasi, "Is Employee Ownership an Unstable Form? Or a Stabilizing Force?" and Avner Ben-Ner, W. Allen Burns, Greg Dow, and Louis Putterman, "Employee Participation in Ownership: An Empirical Exploration."

Margaret M. Blair and Mark J. Roe, eds., *Employees' Role in Corporate Governance* (Brookings, 1999).

Joseph Blasi and Douglas Kruse, *The New Owners: The Mass Emergence of Employee Ownership in Public Companies and What It Means to American Business* (HarperBusiness, 1991).

Joseph Blasi and Douglas Kruse, "Employee Ownership, Employee Attitudes, and Firm Performance: A Review of the Evidence," in Daniel J. B. Mitchell, David Lewin, and Mahmood Zaidi, eds., *Handbook of Human Resource Management* (JAI Press, 1997).

Joseph Blasi, Michael Conte, and Douglas Kruse, "Employee Stock Ownership and Corporate Performance among Public Companies," *Industrial Labor Relations Review*, October 1996.

long history of employee ownership include professional consulting firms (law firms, accounting firms, other business consulting firms, many of which begin as partnerships), financial firms such as brokerage houses and investment banks, and defense contractors. Grumman, Lockheed, McDonnell Douglas, Northrop, Rockwell, and Textron, for example, were all more than 20 percent employee-owned in 1991, before a round of defense industry consolidation swallowed the identity of several. In all these sectors, the work that most employees do involves substantial professional judgment.

Two features of employee ownership firms strongly suggest that their aim is to increase employee commitment and motivation. First, stock compensation tends to come on top of other compensation (except in the relatively few cases in which employees make wage and benefit concessions in exchange for equity shares). Overall compensation is slightly higher on average among firms with substantial employee share ownership, and it increases with the percentage of shares owned by employees. Second, firms with large blocks of shares held by employees also tend to be more stable in their employment levels, suggesting that employment security may be an important complement to employee ownership. This stability apparently does not come at the expense of firm performance, because firms with large blocks of shares held by employees have tended to have a higher rate of return in the stock market than other similar firms.

Corporate executives often claim that their employees are their most important asset. Indeed, a growing share of the value being created by corporate activity comes from intangible assets such as "human capital"—the skills, special knowledge, responsiveness, adaptability, and innovativeness of employees, together with their relationships to each other and to customers and suppliers. One way to interpret the growth in employee share ownership, then, is that employers are finding it much more important to engage employees as "partners" in the

value creation process, by sharing in risks and rewards.

Limits to Growth

Two risks on the horizon may limit the growth in employee shareownership. The first is a stock market downturn. Stock option awards and other equity-based forms of compensation have been popular with employees in a bull market. And employees' interest in stock options has been fueled by media attention to secretaries and mid-level technicians in high-tech firms whose stock grants have made them millionaires. But in a declining market, employee morale could suffer, and stock options could lose their appeal (unless companies are willing to "reprice" the options, a move that could trigger opposition from shareholders). Employees who were happy to share the rewards of equity participation in good times may suddenly decide they prefer less risky and more stable forms of pay when times are less good.

The second risk exists even if the market continues its rise. If employees exercise their stock options in large numbers, outside shareholders could begin protesting the diluting effect of these option grants on the value of their shares. It may well be that the old potential tensions between employees' interests and shareholders' interests are not magically resolved by turning employees into shareholders.

Nonetheless, the idea of employees being major shareholders in the firms where they work has widespread appeal. In survey after survey, members of the general public, working people in particular, say that they believe that employees in substantially employee-owned firms work harder and better—and are more likely than outside shareholders to vote their shares in the long-term best interests of the company. They also say they themselves would prefer to work in such a company. As employees' stake in their firms is increasingly recognized through explicit share ownership, firms may find it easier over time to resolve the old tensions between workers and shareholders in ways that keep the firms productive and focused on wealth creation. ■

Welfare Work

By Isabel Sawhill

Toward a New Antipoverty Agenda



Debates about poverty in the United States have for decades centered on what to do about cash assistance for those unable to work. With the enactment of welfare reform in 1996, the debate has entered a new phase: what to do about those who can work but remain poor nonetheless.

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From Welfare to Work

By some measures welfare reform has been a stunning success. Caseloads declined 38 percent between August 1996 and the end of 1998. A majority of former recipients are now working. Most studies put the proportion employed at between 60 percent and 70 percent. Many of the rest are probably living with family or friends. Equally important, fewer people are applying for welfare: women who might once have turned to the government for support appear to be finding jobs instead. Reports of increased homelessness or other instances of extreme hardship are few, and many welfare recipients report that they are satisfied with the new rules. (In a South Carolina survey, three-fourths of ex-recipients said they were better off than when they were on welfare.)

But this is only half the story. Over the longer term, the strong job market that has enabled so many people to escape welfare may falter. Temporary sources of assistance, whether from relatives and friends or from the welfare office, may dry up. And mothers who do find work may not earn enough to support themselves and their children.

For all these reasons, the debate has now shifted from how to end welfare to how to support the working poor.

And, indeed, government supports for the working poor—the Earned Income Tax Credit and Medicaid in particular—have expanded rapidly in recent years. Not all of this assistance shows up in published data on poverty because the official measure excludes taxes and noncash benefits. But according to the Congressional Budget Office, changes in law since 1984 have increased the assistance available to low-income working families almost tenfold. Combined with the declining generosity of the welfare system, this enhanced support for employed adults has greatly increased people's incentive to work. And as my colleague Gary Burtless has shown, the employment rate of never-married mothers, the group most likely to have been affected by these changes, increased quite dramatically in the past decade and a half—from 36 percent in 1984 to almost 62 percent in 1998. In short, both public policy and private behavior have undergone enormous if unheralded change since 1984, and many studies suggest that the greater work incentives built into the new policies are partially responsible for the higher employment rates among unmarried mothers.

Low-Wage Jobs and the Poverty Rate

A single mother with two children who works full-time, all year long, at a minimum wage job will earn a little over \$10,000 a year. The spendable income of this family, adjusted for payroll

taxes, the Earned Income Tax Credit, food stamps, and child care expenses, is roughly \$11,000, just a little below the federal government's official poverty line for a family of three (\$12,273 in 1996). If this mother has no child care expenses—perhaps because there is a grandmother in the home—she will be considerably better off. Similarly, two-parent families are much less likely to be poor than single parents. If one parent stays home, no child care expenses offset their relatively low income. If both work, their combined income will be almost twice as high. For this and other reasons, poverty rates are five times higher for one-parent than for two-parent families. Thus, one clear solution to poverty is to bring back marriage to low-income communities. The problem is that no one knows how.

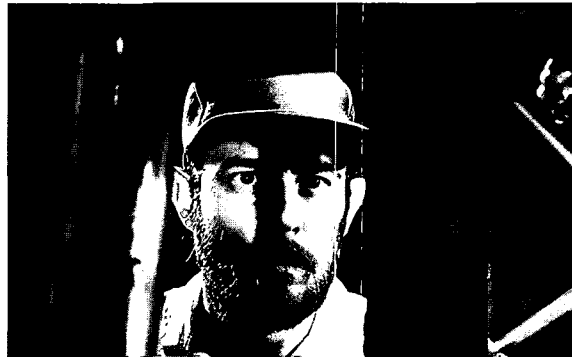
Most mothers leaving welfare earn a bit more than the minimum wage, perhaps \$6.00 to \$7.00 an hour according to various studies. Their families will probably be slightly above the poverty line, although their exact circumstances will depend on how many hours they work, how much they earn, and how

much they pay for work-related expenses, child care in particular. Even if they end up above the official poverty line, bear in mind that the poverty line was established four decades ago when overall incomes were much lower. If we adjusted the poverty line for this three-person family to make it bear the same relationship to average incomes that it did in 1963, it would now be closer to \$20,000. So by contemporary (as opposed to 1960s) standards, none

of these families will have even minimally comfortable lives.

What If Everyone Worked Full-time?

In 1996, the poverty rate for all people residing in families in the United States was 12.2 percent. Many of the people in poverty, however, lived in families where the head did not work or worked less than full-time. The question I ask is how many would still be poor even if they worked full-time throughout the year? To answer this question, I first adjust for the fact that many of those not working have been discouraged from working precisely because they are less employable, or have less earning power, than those who already have jobs, and I assign them wages that reflect their own earnings capacity. Second, I subtract from their incomes the most important work-related expense, the cost of child care. In reality, many low-income families use unpaid care, but it is not realistic to assume that unpaid care can be a permanent solution to the poverty problem. For one thing, the supply of grandmothers or others who are not themselves employed and thus available to care for children is increasingly limited. For another, some



of this unpaid care is of dubious quality. No one wants to reduce poverty by creating more latchkey children. Third, I measure income after taxes, including income and payroll taxes that reduce net incomes and the refundable Earned Income Tax Credit (EITC), which supplements the incomes of most low-wage workers, especially those with children.

Once the data are adjusted in all these ways, the share of people who would have been poor in 1996 if the head of the household had worked full-time for the entire year becomes 3.6 percent. For families with children, the share is 4.9 percent and for those without children it is less than 1 percent. Assuming that everyone works full-time doesn't solve the poverty problem, but it reduces it substantially.

What More Could Be Done?

Although a poverty rate of 3.6 percent is a big step in the right direction, it still leaves about 7 million people below the poverty line. What else could be done to ensure that once people were working, they wouldn't be poor?

Table 1 illustrates the results of three policy changes that might address the problems of working poor families, especially those with children. The first policy change, increasing the minimum wage from its present value of \$5.15 to \$6.00 an hour, would have modest effects. The minimum wage is not well targeted to poor families; many of its benefits flow to low-wage workers, such as teenagers, in higher-income families. A second alternative, increasing the value of the EITC by one-third, has slightly bigger effects, cutting the poverty rate a full percentage point from 4.9 to 3.9 percent among families with children. The third alternative, providing subsidized child care to every family that, absent such assistance, would be poor lowers the poverty rate even more, from 4.9 percent to 2.9 percent among families with children. The reason is straightforward. Most families who remain poor despite working full-time are headed by single parents. Most of these parents are women with little education and earning power. Without subsidized child care, most will remain poor. The reality is that despite increased public spending on child care in recent years, many low-income families still rely on unpaid care because existing public funds cannot guarantee a slot for every low-income child whose mother is in the work

force. Finally, I look at the combined effects of a more generous EITC and child care subsidies for poor families. Together they reduce the poverty rate to 2.4 percent among families with children.

Achieving the Work Standard

Work is a powerful antidote to poverty. Indeed, as we have seen, it virtually eliminates poverty among families without children. For those families with children, adding subsidized

TABLE 1.
Poverty Rate for Individuals in 1996 under Different Assumptions about Work Behavior and Government Supports

	PERCENT POOR		
	TOTAL	FAMILIES WITH CHILDREN	FAMILIES WITHOUT CHILDREN
ACTUAL			
All families (includes elderly and disabled family heads)	12.2	16.7	6.1
ESTIMATED (see note)			
If all family heads worked full-time at predicted wage and single heads had to pay for child care	3.6	4.9	.9
If minimum wage were increased to \$6 an hour	3.4	4.6	.9
If value of EITC were increased one-third	2.9	3.9	.9
If child care costs were fully subsidized for all families that would otherwise be poor	2.3	2.9	.9
If value of EITC were increased one-third and child care costs were fully subsidized for all families that would otherwise be poor	1.9	2.4	.9

Note: Estimated poverty rate is the rate that would have applied to all nondisabled, nonretired household heads in 1996 if they had worked full-time (40 hours a week) and year-round (52 weeks) at their predicted hourly wage. Wage rates are predicted based on age, education, race, and gender for every household head, including those with no earnings in 1996. The poverty rate is based on comparing total family income to the government's 1996 poverty thresholds for a family of a given size. Income is adjusted for federal income and payroll taxes as well as child care expenses, which are imputed to every single parent whether the mother currently pays for care (at a rate of \$4,000 a year for families with one or more preschool children and \$1,000 a year for one or more school-age children under the age of 15). Incomes are adjusted for the EITC and child credit where applicable. No changes in behavior in response to policy changes are assumed.

child care for all poor families and a more generous EITC to our current menu of policies goes a long way toward ensuring that those who work will not be poor. But how realistic is full-time work? Suppose someone loses a job or cannot find one in the first place and experiences many months of unemployment in the process? Although low wages are an issue for the poor, most of whom have limited education and skills, much more important is the fact that many of them do not work continuously. These intermittent work patterns reflect both the instability of many low-wage jobs and personal problems, such as

illness or lack of child care, that cause workers to drop out of the work force. They may also reflect the workers' own preferences. Low-wage work is often unpleasant, and, given any kind of a safety net (public or private) to fall back on, many people will simply opt out of work altogether. Also, although it is not likely to be an issue in today's tight labor markets, when jobs are scarce, workers with the fewest skills tend to go to the end of the hiring queue and may remain unemployed for lengthy periods through no fault of their own.

Still, we are within striking distance of eliminating poverty through work. The remaining agenda involves what to do about slack labor markets and intermittent work patterns that reduce people's annual earnings.

Too Few Jobs

A common lament is that annual earnings are low because unskilled or disadvantaged workers cannot find jobs, except perhaps temporarily. Almost everyone recognizes that jobs are easier to come by in tight labor markets than they are during, say, a recession. And less-skilled workers benefit disproportionately when the unemployment rate falls. Between 1993 and 1998, for example, the employment rate rose more than 9 percent among high school dropouts but less than 1 percent among college graduates. Thus one solution to lack of employment among less-skilled workers is macroeconomic policies that keep employer demand high. But even in good labor markets, there may be some workers whom employers will not hire because of personal characteristics. One possible response is to offer such workers a publicly subsidized community service job. A recent experiment with such a policy in Milwaukee suggests that it can have modest effects. Employment rates among the low-income group offered full-time jobs were about 10 percent higher than those among controls after one year. All the improvement was due to the availability of the subsidized jobs. Such jobs may serve as the ultimate safety net in a work-based antipoverty agenda.

Intermittent Work Patterns

Another possible reason for sporadic employment among low-paid workers is its lack of consequences. Time spent out of the labor force carries few penalties, and a continuous work record carries few rewards. Unskilled workers typically do not advance much over the course of their careers. An individual making \$7.00 an hour at age 20 may earn little more by age 45. For example, from 1979 to 1990 hourly

earnings of former AFDC recipients increased less than 1 percent a year, according to Gary Burtless. This lack of wage progression means that, unlike more educated workers, low-wage workers may have little motivation to accumulate experience on the job. To address this problem, experiments with experience-conditioned benefits for the working poor may make some sense. Just as private employers often reward longer-tenured workers with additional benefits, such as increased vacation time, so too might governments reward them with enhanced benefits of various kinds. Even a modest adjustment in the EITC to provide greater supplements to those with more years of work experience (on a prospective basis) might create an incentive for the poor to make a more serious commitment to the labor force. States are now adding earned income credits to their arsenal of antipoverty measures and could make these credits vary with months or years of experience. Other benefits such as subsidized health care or child care could be treated in similar fashion. Both to contain costs

and to provide the biggest incentives for those with the least experience, the bonuses should be front loaded. That is, the biggest rewards for continuous employment should come in the first few years after leaving welfare or some other period of extended joblessness and should level off thereafter. The intent, however, would be to provide low-skilled workers with the same kind of rewards for continuous employment that typically flow to those

with more skills on the grounds that both they and society would benefit from their greater attachment to the labor force.

Finishing the Job

Ending poverty as we know it is not an impossible dream. By combining requirements that adults work with adequate supports for those that do, and assuming reasonably good labor markets, it should be feasible to reduce poverty and hardship to minimal levels at a cost that is well within reach. The most pressing needs are child care subsidies and health care insurance for adults who now lack such coverage. In the long run, improvements in education and more intact families are the best insurance against poverty. But in the interim, work remains the most powerful antidote to poverty and social exclusion. The new supports for the working poor enacted on a bipartisan basis over the past several decades are a huge step forward. We should now finish the job by rewarding not just work, but steady work, and by ensuring that single mothers have the child care that they need. ■





Help Wanted

Connecting
Inner-City
Job Seekers
with
Suburban Jobs

By Bruce Katz and Katherine Allen

LLOYD WOLF

Cities have historically been the hubs of economic activity in America—the focal points of commerce where farmers brought crops and livestock, where office buildings bustled, and where manufacturing industries thrived. In short, cities were the places where people worked. Suburbs began growing up around the cities in the 1950s and 1960s, but they were originally mostly residential. People commuted from them to jobs in the city. Now, though, after decades of decentralization from city to suburb to exurb, the landscape of home and work has radically changed.

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Today, work is still central to the role of cities in the new knowledge-based economy. With the U.S. economy booming, many new jobs are being created in central cities. Between 1993 and 1997, for the first time in nearly 30 years, central city job growth rivaled both national and suburban growth rates. Urban unemployment rates fell nearly 40 percent between 1993 and 1999.

But the new jobs in the cities are not available to everyone. The decentralization of people and jobs in American society today has left many in our cities struggling. People in poor, spatially isolated urban neighborhoods are ill prepared to compete in the new economy. Ironically, the entry-level jobs they need abound—but in the suburbs, out of reach. And efforts by government to connect less-skilled workers in the city with jobs in the suburbs are generally fragmented and needlessly parochial; in the end they hinder rather than help inner-city residents gain access to regional job opportunities.

Decentralization Is the Rule

Between 1980 and 1997, 23 of the 25 largest U.S. cities either gained population more slowly than did their surrounding regions or lost population while the region gained. Overwhelmingly, whether a city is growing, maintaining its population, or shrinking, it is losing ground to its larger metropolitan area.

Especially damaging is cities' loss of middle- and upper-income households, the backbone of economically strong communities. From 1989 to 1996, 7.4 million such households left cities for suburbs while only 3.5 million moved from suburb to city. Median household incomes of cities and suburbs thus continue to diverge. In 1989 suburban median income was 58 percent higher than central city median income; by 1996 the gap had widened to 67 percent.

Despite relatively healthy 1.8 percent

central city job growth over the past four years (compared with 1.8 percent nationwide and 1.9 percent in the suburbs), the long-term picture for many cities is one of continuous and rapid decentralization of people and jobs, especially in sectors most vital to low-skilled inner-city residents. Cities' share of regional employment is falling, particularly in older industrial cities. From 1994 to 1997, Ohio's seven major central business districts (Akron, Cincinnati, Cleveland, Columbus, Dayton, Toledo, and Youngstown) gained only 636 net new jobs, while their suburbs gained 186,410. Atlanta had 40 percent of all metropolitan area jobs in 1980, but only 24 percent in 1990. Washington, D.C.,

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had 33 percent of its region's jobs in 1990, but only 24 percent in 1997, while the outer suburbs' share grew from 38 percent to 50 percent.

The decentralization rule—like all rules—has its exceptions. Cities retain a stock of existing jobs that, at times, is substantial and should not be neglected. In Ohio, for instance, while central city job growth has been relatively stagnant, the central city still has many jobs in absolute terms. While the suburbs of Ohio's seven major cities captured 90 percent of all employment growth between 1994 and 1997, the central cities still have more than a third of the regional jobs (1.2 million out of 3.3 million).

But despite the numerous jobs, the central cities still lag behind their suburbs. During 1993–99, while the central city jobless rate fell from 8.5 percent to 5.2 percent, the suburban rate fell from 6.7 percent to 3.8 percent.

Urban Residents and Central City Jobs

In the wake of this decentralization, central cities increasingly have become home to those who rely on welfare, subsidized health care, and other social services. Although poverty has declined in central cities, urban poverty rates are still twice suburban rates, 18.8 percent as against 9.0 percent in 1997. Urban neighborhoods of concentrated poverty—those where at least 40 percent of residents are poor—more than doubled in number between 1970 and 1990.

People in these neighborhoods often face a triple whammy: poor schools, weak job information networks, and scarce jobs. They are more likely to live in female-headed households and have less formal education than residents of other neighborhoods. Education expert Diane Ravitch has found that fourth graders from high-poverty urban neighborhoods have dramatically lower National Assessment of Educational Progress scores than their

suburban counterparts. Although nearly two-thirds of suburban children achieve “basic” levels in reading, less than a quarter of children from high-poverty neighborhoods do so. Only about a third achieve basic levels in math and science, half the fraction of suburban students.

As poverty concentrates to the detriment of the life chances of the residents, many cities are shifting to a more knowledge-intensive, white-collar service-oriented economy. Many traditionally urban employment sectors—banking, health care and hospitals, manufacturing—are growing more slowly than they once did, if they are growing at all. They have declined particularly in

the “Rustbelt” cities in the Northeast and Midwest.

As urban economies shift from blue- to white-collar industries, from goods producing to information processing, higher skill requirements place these new jobs out of reach of many inner-city residents. So while many new knowledge-intensive jobs are physically accessible to residents of poor city neighborhoods, they are functionally inaccessible. And the problem may only get worse: the Educational Testing Service estimates that individuals with “minimal skills” will qualify for only 10 percent of all jobs generated between now and 2006.

Furthermore, in high-poverty neighborhoods, the social networks crucial to connecting people to work—networks that most of us take for granted—often break down. Employed people, with the inside track on their firms’ job openings, tell their friends or families about open positions and then vouch for applicants to their employers. In poor neighborhoods, where relatively few people work and even fewer have good jobs, these networks are circumscribed and overburdened. Low-wage workers also tend to keep their job search close to home, cutting themselves off from plentiful suburban jobs.

Although overall urban joblessness is in decline, unemployment and underemployment rates remain high within low-wage labor markets. Overall unemployment in New York City, for example, was 7.9 percent during 1994–96, and underemployment—including those who are unemployed, discouraged about work (looked for work in the past year but gave up for lack of job prospects), involuntarily part time, or constrained by factors like inadequate child care or transportation—was 13.4 percent. And both un- and underemployment hit young, non-college-educated inner-city minorities hardest. According to economist Jared Bernstein, for example, un- and underemployment rates in New York City

during 1994–96 were 48.8 percent and 61.1 percent, respectively, for young black men (ages 16–25) without a high school diploma.

Inner-city residents are clamoring for the scarce jobs for which they are qualified. Anthropologist Katherine Newman counted 14 job seekers for every minimum wage, fast food job in Harlem. Welfare reform could exacerbate this competition for entry-level positions by moving large numbers of unskilled people into urban labor markets. In New York City, researchers found that only 29 percent of adults leaving the welfare rolls between July 1996 and March 1997 found full-time or part-time jobs. In Philadelphia, to

employment rates were stable. At the same time, single mothers’ nonemployment fell from 43 percent to 31 percent.

Although the nation’s economy is booming, the economy alone is not enough to connect the nation’s urban poor to work, let alone move them toward self-sufficiency. Self-sufficiency—getting by without help from the government or private charities—is a high hurdle to clear. A single parent with a pre-school-aged child living in Boston would have to earn \$15.28 an hour, or \$32,000 a year, working 40 hours a week, 52 weeks a year, just to make ends meet on a no-frills, no-subsidy budget. Low skills and lack of work experience put \$15-an-hour jobs out of reach for most poor inner-city residents.

Government efforts
to connect urban
workers with jobs in
the suburbs are often
fragmented and
needlessly parochial.

Can Government Make Connections?

In the suburbs, entry-level jobs abound in manufacturing, wholesale trade, and retailing. All offer opportunities for people with limited education and skills, and many pay higher wages than similar positions in the central city. But persistent residential racial discrimination and a lack of affordable suburban housing effectively cut many inner-city minorities off from regional labor markets. Low rates of car ownership and inadequate public transit keep job seekers in the core from reaching the jobs at the fringe. Often, inner-city workers, hobbled by poor information networks, do not even know that these jobs exist.

Government does little to solve—and sometimes worsens—the problem. Fragmented governance of federal and state programs within metropolitan areas, for example, keeps housing voucher recipients from learning about housing opportunities in other jurisdictions. In the Detroit metropolitan area alone, 31 public housing agencies administer separate federal Section 8 programs.

Public job training and worker education programs are similarly fragmented. Labor markets do not stop at jurisdictional lines—people in a metro-

address the needs of more than 36,000 jobless workers and 63,000 welfare cases, state and city governments fashioned an innovative transitional work program to create public jobs. But the program will create a mere 3,000 jobs in a city that lost 100,000 jobs, or 13 percent of its total employment base, between 1989 and 1995.

Not all employment trends are discouraging for inner-city populations. Between 1992 and 1998, nonemployment rates, which include both jobless people seeking work and people officially considered “out of the labor force,” fell from 48 percent to 36 percent for young black men without a college education, although overall non-

politan area may work in one jurisdiction, live in another, and shop in yet another, without even thinking of the political boundaries they cross. But the need to navigate multiple bureaucracies can impede the job mobility of people who depend most on public work force systems. Under current federal law, jurisdictions with a population of 200,000 or more can essentially splinter off and create their own local work force systems. Metropolitan areas with millions of people may have dozens of separate work force bureaucracies. Wealthier jurisdictions have no incentives to serve inner-city populations, and inner-city jurisdictions have little access to information about suburban jobs.

Fragmented governance also abets the concentration of poverty. The territorial administration of federal housing and work force programs makes it harder for low-income urban families to cross political boundaries to reach opportunities outside their neighborhood.

Connecting inner-city residents to jobs that can pull them out of poverty requires at least four important policy shifts. First, city and regional policymakers need better local labor market information so that they can make informed policy decisions in the context of their current economic reality. Second, social programs should be administered to facilitate—not impede—access to opportunities across jurisdictional boundaries. Third, community institutions need incentives and flexibility to broaden the scope of their responses to neighborhood distress beyond affordable housing. Finally, the mismatch of jobs—enough jobs but in the wrong places or at the wrong skill levels—requires a new metropolitan agenda on jobs, transportation, and housing to link inner-city residents to opportunities throughout their region.

Know Your Region

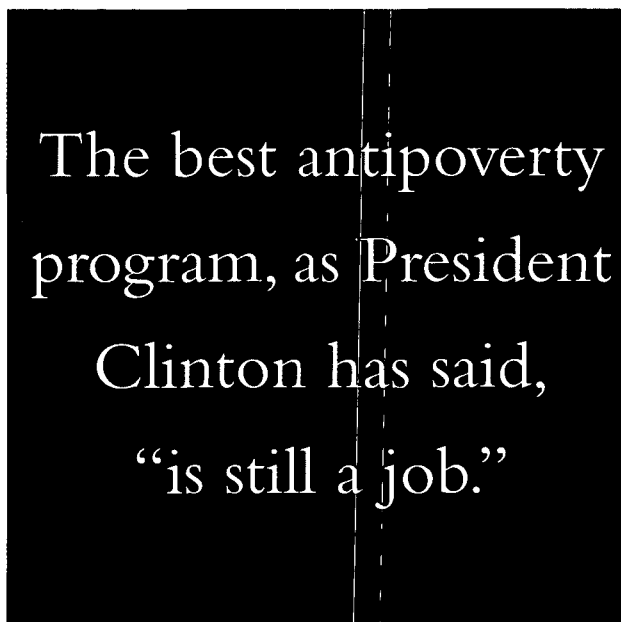
All regions are not created equal. Some, like Detroit and Baltimore, have decen-

tralized radically, leaving the central city economically devastated and potential inner-city workers spatially isolated from job opportunities in the suburbs. In others, like Seattle and Boston, the central city continues to thrive economically despite decentralization, making housing affordability a top concern for inner-city residents who live near plentiful city jobs. This diversity requires that cities and regions take a hard look at their social and economic structure to respond sensibly to their unique situations.

City and regional leaders must gauge their economic competitiveness, identify major social problems, and project significant demographic

households to the outer-suburban entry-level employment.

Building the capacity for such ongoing research—in local universities, city agencies, or community institutions—is essential both to evaluating the effectiveness of existing policies and to developing innovative, targeted policies that can respond to changing economic realities. Federal and state governments should encourage the development of place-based research with new funding sources and more strategic local information-gathering by government itself. Government agencies are already treasure troves of data, much of which should be made available and accessible to the public.



Mirror the Market

Labor and housing markets are regional, not local. For low-income inner-city residents to avail themselves of regional job, housing, and educational opportunities, the government systems they depend on must reflect the “real” metropolitan marketplace. Many social programs, like welfare and job training programs, are funded at the federal level, devolved to the states in block grants, and then administered by local governments, creating multiple bureaucracies within a single labor market. All these programs should operate at the metropol-

itan level. Creating metropolitan entities that administer programs across an entire region or, at a minimum, requiring all block grant recipients to demonstrate cross-jurisdictional collaboration would help public systems and programs more closely mirror the market. Seattle and King County are moving in this direction with the creation of a Coordinated Funders Group, designed to coordinate and even integrate the employment training programs in the region. A diverse group of constituencies including city, county, and state agencies dealing with housing, welfare, job training, and education issues makes up the funders group. In addition to local streamlining efforts, the group has

it is still a job.” trends. They must determine the nature and severity of their problem, and recognize and preserve their competitive assets. Only after making such an assessment can city and regional leaders tailor place-specific solutions that maximize existing infrastructure and build the necessary coalitions to implement effective work force strategies. For instance, in Cleveland, researchers at Case Western Reserve University have mapped the residential locations of welfare recipients, entry-level job opportunities, and public transit systems. Their research has led to the rerouting of many transit lines to better connect the central city and inner-suburban welfare

applied for and been awarded millions in federal funds for training hard-to-serve welfare recipients in both the city and county.

Support Community Institutions

Although a broad spectrum of institutions is needed to connect poor inner-city residents to metropolitan opportunities, community-based organizations—local groups that are intimately familiar with distressed neighborhoods and their residents—are indispensable. These groups, including community development corporations and faith-based groups, must complement neighborhood activities with efforts that involve metropolitan solutions. Policymakers should build and support a network of intermediaries—modeled on the housing intermediaries that have been federally supported over the past 25 years—to link residents to local and regional opportunities.

Community institutions should also be encouraged to play more tailored roles in their communities, providing child care, transportation, job training—whatever services or programs the community needs. Thus far, the policy infrastructure for such community-guided investment has been limited to affordable housing development. However, some exceptional institutions are already very responsive to community needs despite the lack of more comprehensive support for their efforts. The Delaware Valley Community Reinvestment Fund (DVCRF) in Philadelphia, for example, supports a wide range of local and regional activities, including financial support for affordable housing, community facilities like child care centers, small businesses, and workforce development programs. With support from the Annie E. Casey Foundation, DVCRF combines economic and workforce development by financing the expansion of local businesses that agree to hire disadvantaged workers

recruited, trained, and placed by DVCRF's Jobs Initiative.

Improve Access to Suburban Jobs and Housing

Transportation and housing mobility programs must minimize spatial mismatches. The gap between inner-city residents who need jobs and the suburban employers who need workers can be bridged in two ways—by helping people get to and from their jobs and by helping them move closer to where they work. Improved transportation options are essential to connect inner-city residents to job-rich areas on the exurban fringe. Public transit is the

existing employees. Bell South, for example, recently decided to relocate five Atlanta-area office buildings closer to the regional transit lines to ease traffic congestion and employee commutes.

Housing is more controversial. But research on Chicago's Gautreaux program, a court-ordered, locally administered program that has helped nearly 7,000 families move from poor segregated urban neighborhoods into low-poverty suburban areas, has documented gains in employment and education for families who moved to job-rich locations with better schools. Helping families leave high-poverty, racially segregated neighborhoods and move into areas with greater opportunities requires

a variety of policy strategies: metropolitan administration of housing voucher programs, increased funding for mobility counseling, development of affordable housing in the suburbs, and heightened enforcement of existing federal fair housing laws.

The best antipoverty program, as President Clinton has said, "is still a job." But having a job entails having a reliable way to get from home to work; it means knowing about opportunities and being able to take advantage of them. Now is the time—with a booming economy and welfare reform's new focus on work—for the gov-

But having a job
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ernment and private sector to create these supports to help poor inner-city residents find better opportunities for themselves and their children. The four strategies mentioned above are necessary but not sufficient components of a larger urban agenda. Strategies to connect people to regional job and housing opportunities should complement more traditional efforts to grow urban economies, revitalize neighborhoods, and stimulate business investment in cities. Federal, state, and local governments, employers large and small, and community institutions must get involved to help prepare inner-city residents to compete in the mainstream economy. ■

strategy most often mentioned by policymakers, but private car ownership—the solution that most nonpoor people choose for themselves—could also be made accessible to the poor through public subsidy or changes in auto insurance laws.

The public sector should not bear the job access burden alone—employer decisions to locate on the fringe of metropolitan areas, away from established transit lines, often cause these problems in the first place. These private-sector firms should be engaged in devising new transportation solutions as well, because it is in their interest both to gain access to the inner-city labor pools and to make commuting easier for their

A Way

By Joseph P. Viteritti

School Choice and Educational Opportunity

Out

Education is the keystone to opportunity. Time and again, research has demonstrated that academic achievement is positively related to earning capacity, civic involvement, political efficacy, and a host of advantageous personal attributes.

Without at least a high school diploma in hand, a young man or woman is destined to remain on the margins of life in the skill-based world of the next millennium. Yet millions of boys and girls, a disproportionate number of whom are from

minority families living in America's inner cities, remain trapped in failing schools.

Since the U.S. Supreme Court handed down the landmark *Brown* decision in 1954, the federal and state governments have instituted a variety of policy measures to improve educational opportunities for minority and poor children. We have sent children on long bus rides to achieve racial balance, invested billions of dollars in compensatory education programs that do not work, and tinkered on the edges of institutional reform to make school systems more responsive to students' needs. Yet race and class remain the most reliable predictors of education achievement in America.

In the past decade, educators have begun to experiment with "school choice" as a way to increase the educational options open to parents in deciding where their children attend school. The range of choice programs has been diverse. Some are limited to public schools. Other, more controversial voucher plans permit children to attend private and religious schools with public support. During this time choice has evolved from a market model concept embraced primarily by conservatives and libertarians to a policy designed to promote educational opportunity for underserved populations that enjoys wider support.

Joseph P. Viteritti is a research professor of public administration in the Wagner School of Public Service at New York University. This essay is drawn from his most recent book, Choosing Equality: School Choice, the Constitution, and Civil Society (Brookings, 1999).

Polls show that minority and low-income communities strongly endorse school choice, while the white middle class, especially in the suburbs, remains divided. That pattern is not difficult to understand. Minority and poor parents, unhappy with the chronically low-performing schools their children are forced to attend, want alternatives. Middle-class parents, who are content with the quality of their children's schools, are less motivated to seek change.

In fact, many middle-class families already enjoy choice under the prevailing arrangement. Not only do they have the means to acquire a private school education, they also have the economic mobility to reside in communities where the quality of public schools is relatively high. According to a National Household Survey released by the Department of Education in 1997, the quality of local public schools is a key factor in determining where people with school-age children decide to live. Poor families usually do not have the luxury of making such decisions.

Today the most compelling argument for school choice is an egalitarian one: some people have it, and some do not; those who do not have it want it; and those who do not have it need it to escape the dreadful schools to which their children are habitually assigned. If we are to realize the goal of equal opportunity in education, the question is not whether to have choice in America, but whether choice should be available to all, regardless of income or social class.

As with previous policies to improve educational opportunities for poor and minority children, a simple declaration of noble intentions is not enough to get us where we need to be. If school choice is to provide educational opportunity to disadvantaged communities, policy must be consciously designed to do so.

Evolution of an Idea

Milton Friedman first put forward the idea of school choice in the mid-1950s. His free-market approach was intended to bring competition into education and reduce the role of government. Friedman and his followers envisioned a Darwinian

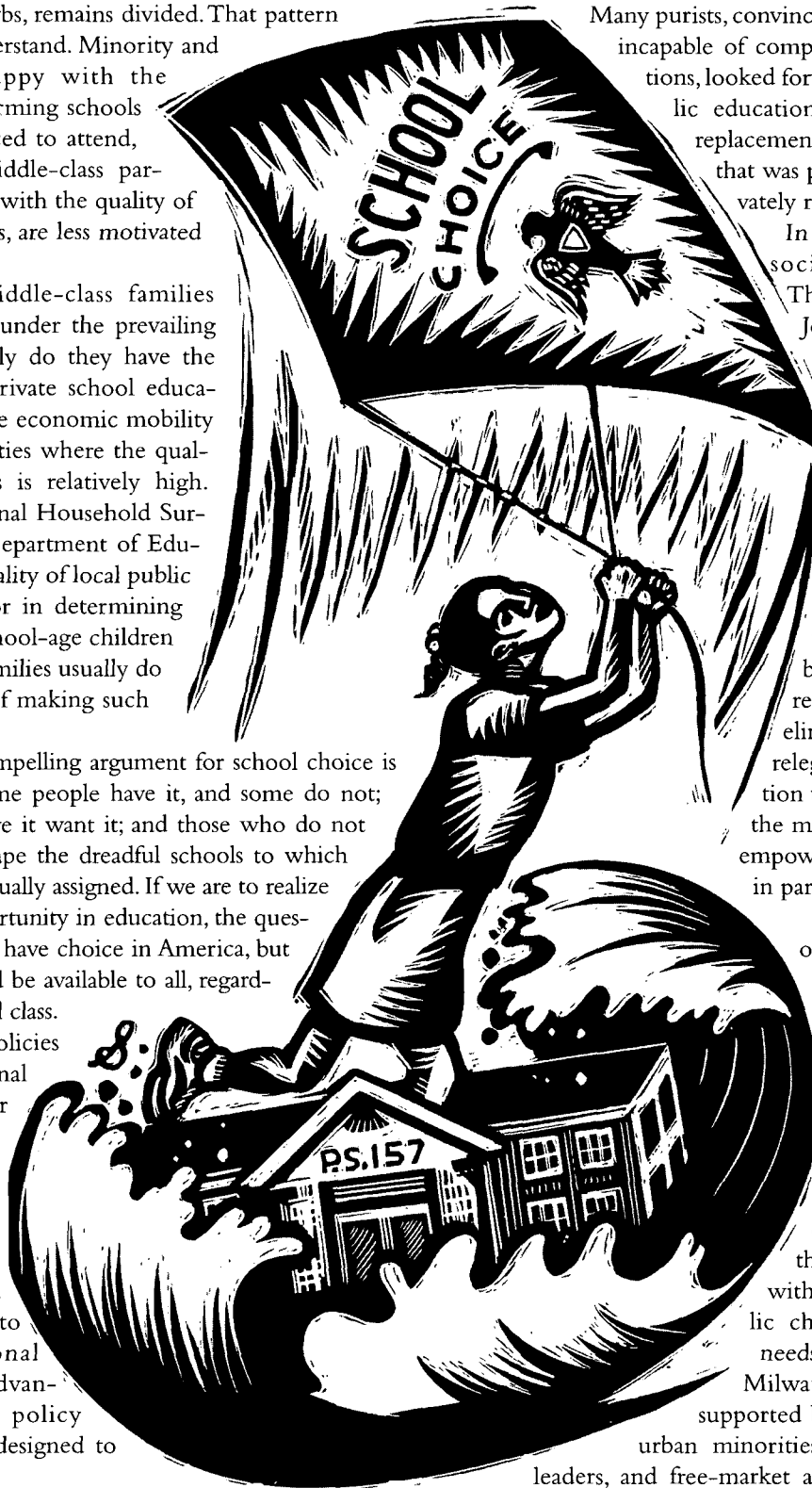
struggle that would force undersubscribed inferior institutions to close and provide the rest with an incentive to improve.

Many purists, convinced that public schools were incapable of competing with private institutions, looked forward to the demise of public education as we know it and its replacement by a system of schools that was publicly supported but privately run.

In the early 1970s liberal social theorists such as Theodore Sizer, Christopher Jencks, John Coons, and Stephen Sugarman put forward their own voucher proposals. The plans differed, but their unifying principle was to extend educational opportunities to disadvantaged students who were not well served by public schools. These reformers did not want to eliminate public schools, nor relegate the future of education to the impersonal forces of the market; but they did seek to empower parents—poor parents in particular.

The publication in 1990 of John Chubb and Terry Moe's *Politics, Markets, and America's Schools* brought the debate over school choice more into the mainstream, but support came slowly. Over the next few years the "opportunity" model of choice gained traction in the practical world of policy with the development of public charter schools, as well as needs-based voucher plans in Milwaukee and Cleveland—all supported by an unusual coalition of urban minorities, white liberals, business

leaders, and free-market advocates. While those on the right were confident that expanded choice would introduce healthy competition to education, those on the left were beginning to come to terms with the reality that traditional public schools, especially the big bureaucratic systems of the inner city, were failing large numbers of poor and minority children.



STEPHANIE SHIELDHOUSE

This cruel fact of life motivated black parents in Milwaukee and Cleveland to demand vouchers in their state legislatures in 1990 and 1995. Unlike the earlier market models, the voucher plans in Milwaukee and Cleveland were specifically targeted to benefit low-income and underserved communities. Earlier this year Florida passed the nation's first statewide voucher law, and it is targeted to children who attend failing public schools.

Although channeling public dollars into private schools raised the ire of many on the political left, voucher programs enabled poor people to enter an education market that until recently was the prerogative of the middle class. In this sense the new voucher programs have as much in common with the redistributive policies of a liberal social agenda as they do with the ideological predilections of free-market advocates.

Publicly supported voucher programs have been complemented by a variety of private scholarship initiatives. Most target poor families, but offer only a partial scholarship. CEO America offers 13,000 scholarships in 38 cities. The Children's Scholarship Fund (CSF) offers 40,000 scholarships in 45 locales. Last spring CSF received 1,250,000 applications, an astounding plea for relief from poor parents who were willing to forgo a free public education and absorb part of the tuition costs for private school. The CSF program was endorsed by many public officials who oppose publicly supported vouchers, including President Bill Clinton. It also received strong public backing by opinion leaders in the minority community such as Martin Luther King III, Andrew Young, Maya Angelou, and Oprah Winfrey. The CSF experience highlights a growing dilemma in the Democratic party, which has always represented itself as a champion of the downtrodden, but at the same time relies on the political support of teachers' unions and other organized education groups that oppose choice.

Meanwhile the simultaneous growth of charter schools—public schools of choice that operate outside the legal jurisdiction of regular school districts—made it possible for many supporters of public education to sign on to choice without having to support vouchers. Nearly 1,200 such schools now operate in 36 states and the District of Columbia. Charter

schools have the potential to provide stiff competition for private schools as well as for traditional public schools.

What Have We Learned?

Demand for choice, especially among minorities and the poor, is high. We know this from the size and composition of the waiting lists of applicants who have expressed interest in existing voucher programs, charter schools, and private scholarship initiatives. Even charter schools that do not specifically target poor children tend to attract a disproportionate number of minorities who see them as an escape route from failing schools.

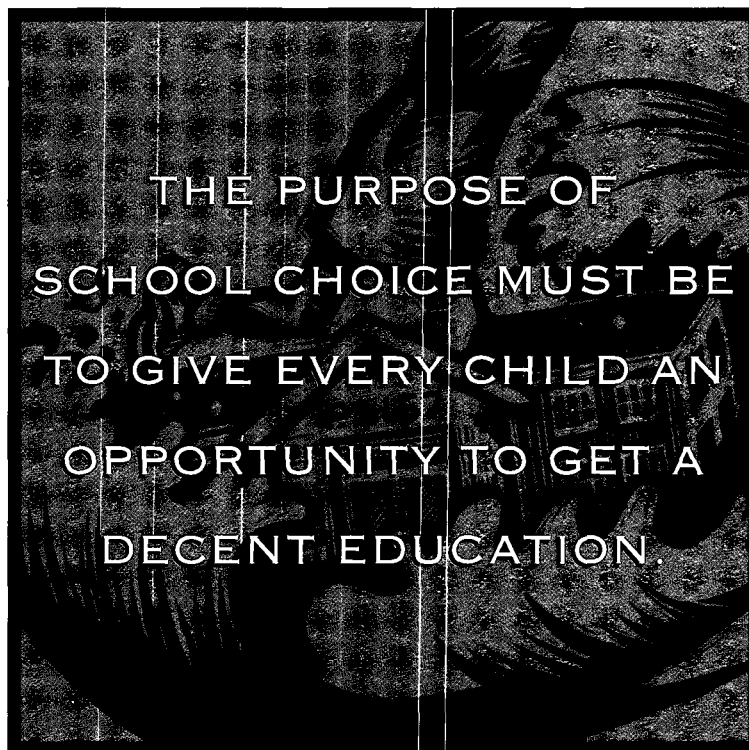
While these long waiting lists confirm the demand for choice expressed in polls, they are also a function of deliberate public policy engineered as legislative compromises between combatants on opposite sides in the political struggle. From the outset the state laws that created choice in Milwaukee and Cleveland

placed strict caps on the number of students. During the first four years of its operation, the program in Milwaukee was capped at 1 percent of student enrollment. (It was raised to 15 percent in 1995.) The Cleveland program, which began with 1,800 students, was capped at 3,700 last year even though applications exceeded 17,000. The latter's future remains altogether uncertain because of legal challenges launched by its opponents.

All but a few charter school laws impose rigid limits on the number of schools permitted. Most charter schools are also underfunded. They do not enjoy financial par-

ity with other public schools regarding operational funds and are especially handicapped by the lack of adequate start-up and capital budgets. This "opportunity tax" imposed in the course of legislative horse trading between supporters and opponents is a serious disincentive to individuals who might be inclined to start charter schools, and it imposes an unfair competitive disadvantage on those who have. A similar bargain was struck in setting the amount of aid appropriated to voucher students in Wisconsin and Ohio. Given the high proportion of disadvantaged children who enroll in choice programs, these cynical deals turn the concept of compensating spending right on its head.

There is encouraging evidence from Milwaukee, Cleveland, and a half-dozen private scholarship programs that poor children who attend private schools benefit academically.



Although the evaluations of these programs remain mired in methodological debates, increasingly persuasive research evidence indicates that disadvantaged students perform better in parochial schools than in public schools, especially when performance is measured by graduation rates. No definitive evidence yet exists on the academic performance of charter schools compared with regular public schools. A consistent pattern across the board indicates, however, that parents who exercise choice, either public or private, are more satisfied with the schools their children attend. Among the reasons consistently cited are higher academic standards, safer schools, and better opportunities for parent involvement. While skeptics question whether such testimonials are a true measure of school quality, it is apparent that poor parents perceive the act of choosing, in and of itself, to be a form of opportunity—one that, until a short time ago, they had not enjoyed.

There is also across-the-board evidence that, among the poor, those who exercise choice tend to be better educated and marginally advantaged. The pattern is most pronounced in private scholarship programs where parents are expected to pay part of the tuition. Although this does not necessarily detract from the finding that poor children who attend choice schools gain academically, it does raise the question of whether the poorest of the poor would stand to benefit from choice. It introduces a phenomenon that some people refer to as “skimming,” a problem that needs to be addressed through intelligent policy design.

Policy Design: The “Three R’s”

If choice programs are to enhance the educational opportunities of disadvantaged students, they must be designed around three basic principles: Real Choice, Real Competition, and Real Standards. Poor families should have access to as many schools as possible: regular public schools, charter schools, private schools, and parochial schools. No arbitrary limit should be set on the number of charter schools or vouchers allowed.

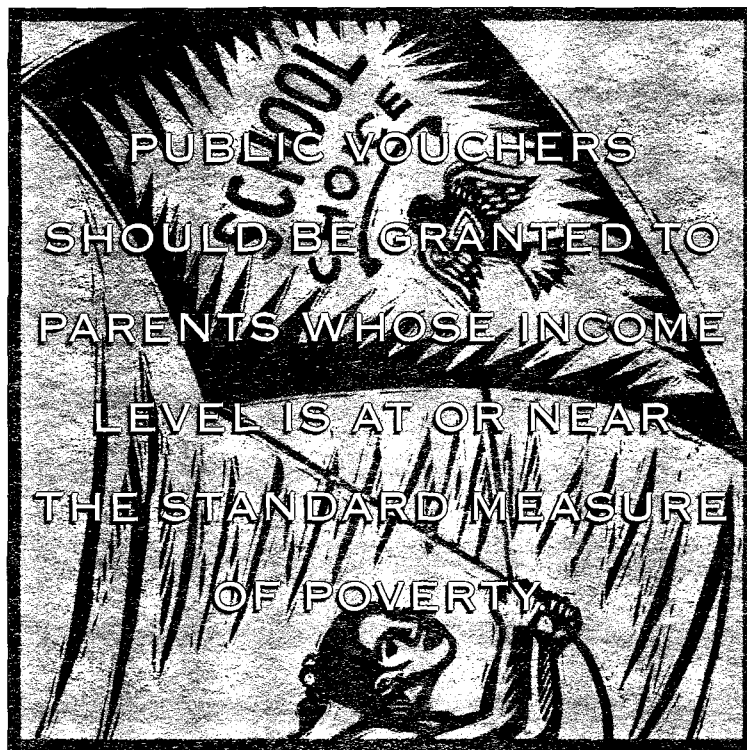
In principle, public charter schools should be available to all students on a first-come, first-served basis. Until enough charter schools exist, however, priority should be given to students from failing schools. The per capita allocation for students who attend charter schools must be equal to the

amount appropriated for students in regular public schools in a given school district.

Public vouchers should be granted to parents whose income level is at or near the standard measure of poverty. The maximum value of the voucher should be equal to the per capita expenditure that a child would receive in public school. Any private or parochial school that participates in the voucher program should be required to accept a voucher as full payment for tuition, and the charge should not exceed the per capita cost of educating the child. To remove all economic barriers to choice, participating families should not be expected to contribute toward the costs of the program. Participating schools should be required to accept all applicants. If the number of applicants exceeds the spaces available, students from failing schools should have priority.

As is always the case, some parents will be less able or motivated to identify the

schools most appropriate for their children’s needs. To prevent children from being left behind in failing schools, public authorities must enact policy that is intolerant of failing schools. Today the policy in most states is to limit the number of charter and choice schools and to let failing schools remain open. Instead, states must set curricular and performance standards that all public schools are required to meet—or be liable for closure. Non-public schools participating in a public choice program should be held to the same standards of accountability and



expected to administer the same standardized tests. Although market purists may perceive such accountability as an intrusion on the autonomy of private institutions, it is wholly justifiable and appropriate for institutions that want to participate in a publicly financed program. This does not mean that nonpublic schools would be unable to develop their own curricula beyond the minimum requirements set by the state or that sectarian schools would be prohibited from incorporating religious values.

The purpose of school choice must be to give every child an opportunity to get a decent education. Before that can happen, public authorities have an obligation to define what that means, develop criteria for determining when it is achieved, and enforce the standards for every school that participates in the common effort to succeed. ■

Beyond Consensus

Much Ado about Job Training

By Anthony P. Carnevale

Nearly everyone agrees that training is a valuable tool for reducing unemployment, underemployment, and income disparity as well as for increasing adaptability in the global economy. Publicly sponsored training appeals to us particularly because it mixes individual responsibility with collective compassion. Yet training consistently looms far larger in policy talk than in public budgets.

To some extent, training gets the budget share it deserves. Much rhetoric on training overpromises. The notion that “If we train, then the jobs will come” is shaky at best. Still, we have learned a great deal, both from our successes and from our failures in training policy, over the past three decades. On the whole, little of what we have learned disturbs the initial intuition that training policy, effectively designed, can be a useful economic and social policy tool. And, after 30 years at it, we know how to design effective training programs.

How We Got Here

Ever since the Kennedy round of global trade agreements in the 1960s, training

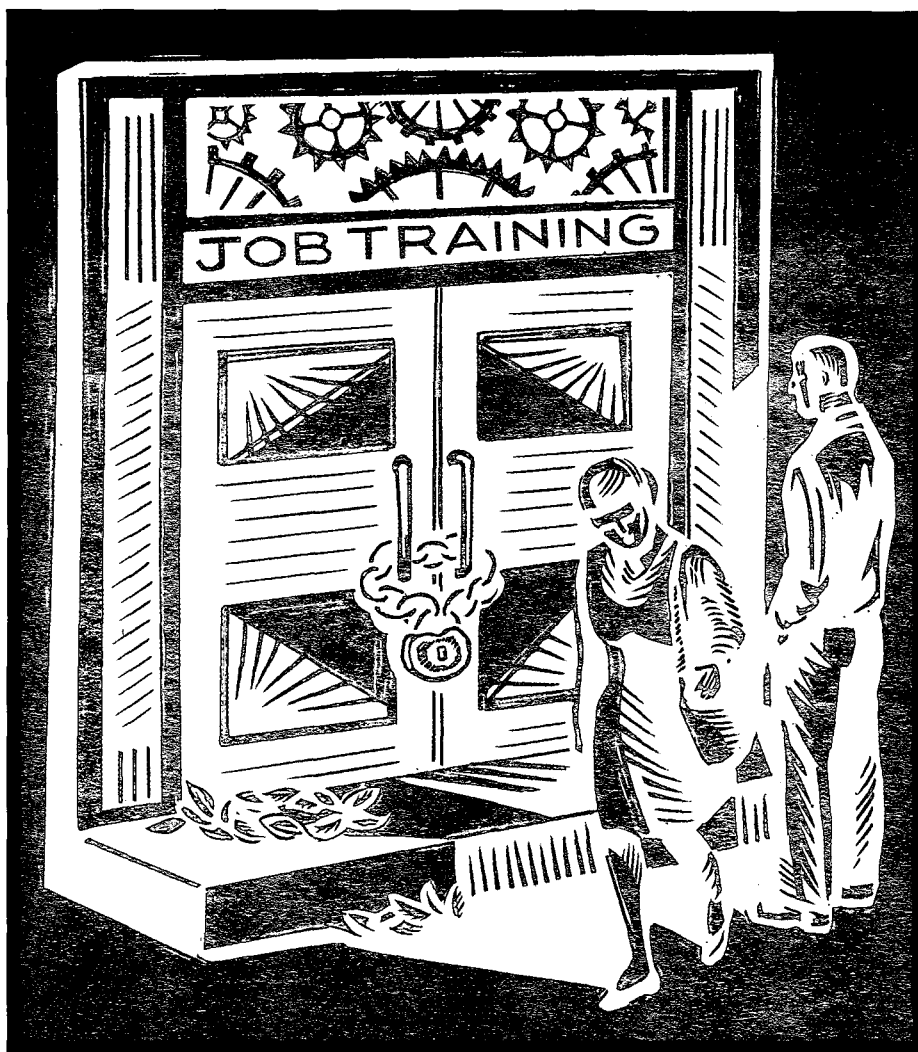
programs for workers dislocated by changes in federal trade, environmental, space, and defense policies have been a staple of federal legislation. Disadvantaged youth and adults became federal training clients when Michael Harrington discovered those “other Americans” not sharing in the general prosperity in the 1960s and again when stagflation and the baby boomers hit labor markets in the 1970s. When economic restructuring and downsizing became genuine concerns in the 1980s, middle-income working people joined the laundry list of eligible recipients for federal training—a list fast outstripping available funds.

By the mid-1980s, a “new economy” was emerging; work was becoming the primary integrative force in society for both men and women. It was generally

agreed that if everyone were at work in a fully mobilized society, everyone would be included not only in the economy but in the polity and culture as well. According to the new orthodoxy, labor market programs needed to focus less on income support when workers became unemployed and more on “reemployment” policies. Economists also began reporting the growing importance of skill in explaining increasing differences in earnings. Despite the rhetorical emphasis on training, however, money for federal training programs declined during the 1980s—from 0.12 percent to 0.09 percent of GDP. And the trend continued. Federal training dollars fell from \$24 billion in 1978 to \$7 billion in 1999.

Still, we kept talking about the importance of training. In the 1992 presidential election campaign, Bill Clinton proposed to supplant the crazy quilt of small programs targeted on the economically disadvantaged and dislocated workers with a new training system that would provide universal eligibility. The new system was to include three elements—a “school-to-work-apprenticeship” program, a beefed-up employer training agenda, and new skill standards for private-sector jobs—to be complemented by an investment program to “rebuild America” and by “high-performance work systems” to encourage employers to retrain workers and reorganize work systems to favor high-skilled workers.

The Clinton proposals did not fare



well. The school-to-work programs survive today only as a policy concept that advocates mixing applied and academic pedagogy and as a program to keep kids in school so they can go on to college. Employers were reluctant to take responsibility for educating and training young people that they might never hire. Employers also feared that proposed national skills standards would add overhead costs and regulatory burdens in a competitive environment that, in their view, demands deregulation and institutional agility.

Clinton's ambitious federal training agenda has hardly reared its head since. During his second term, the emphasis shifted toward expanding grants, loans, and tax credits for postsecondary education. Training policy fell back into the familiar tug-of-war between expert opinion and the interests of agencies and providers over declining resources.

Not to Worry?

Meanwhile, although a booming economy seems to have banished our unemployment problems, helped ease income disparity, and made training seem superfluous, the need to develop a comprehensive, more-effective training strategy remains.

The connections between general economic prosperity and the lives of ordinary working people remain tenuous. Tight labor markets alone are unlikely to close the earnings gap, because on-the-job training ladders out of low-wage jobs are collapsing as entry-level manufacturing jobs decline. The ratio of the 90th to the 10th percentile among male wage earners, which increased from 3.59 percent in 1973 to 4.52 percent in 1993, declined only to 4.47 percent in 1997—closing only 6 percent of the opening gap. In 1996, 3.5 million American workers

worked full-time, full-year, and 4.3 million worked at least 27 weeks and nonetheless lived in poor families. And skill barriers make it increasingly difficult for people to work their way out of poverty. Thirty-nine percent of Americans in the labor force have skills below the minimum competency established by the Organization for Economic Cooperation and Development.

In addition—although no one wants to mention it—we may not have banished economic cycles. At the moment, everything is “just right” in the Goldilocks economy, but the bears may show up eventually. “Generation Y” may not be as easy as the smaller “Generation X” was to integrate into the labor force. In our fully mobilized work-first society, both long-term and short-term economic fortunes are more connected to labor markets, and labor market success is more connected to skill acquisition. At the same time, unemployment, whether individual or mass, is longer-term and more structural, and structural barriers are most often skill barriers. And if skill is the question, training will likely be part of the answer.

Another strong argument for continuing to press for effective public training programs is built on the fundamental belief that all individuals matter and each matters equally. As the world's most diverse postindustrial nation, the United States sets the highest standards for inclusion, both as an extension of its democratic principles and as a recognition that economic differences threaten bedrock institutions. And inclusion begins with universal—and equal—access to good jobs. Training is one way to encourage access, especially for minorities, women, and low-income families.

Restarting the Training Dialogue

Why has our apparent consensus on training not resulted in concerted public action? One obvious explanation is that while support for training and other active labor market policies in the United States has always been wide, it has not been deep. The failure to bring boutique training policies to universal

scale tracks to the political and financial barriers to expanding the welfare state beyond educational guarantees for the young and income and health-care security for a steadily increasing elderly population.

The fragmentation of U.S. labor markets also makes a broad-based training policy difficult. Training, like wages, pensions, health care, and other work-related aspects of the social order, is organized around particular occupations and industries and is, therefore, hard to conduct on a large scale. The fragmentation of education and social welfare benefit levels makes it difficult to switch to a more homogenous national benefit level. (The health-care debate is a case in point.) As a result, government provision of work-related training and other benefits tends to focus only on those who do not have access to private coverage. Thus, private citizens—who might pay for but not benefit from such

programs—do not typically support them.

Minimalist government, in combination with fragmented labor markets, leads to fragmented public programs. With few universal programs, support for funding is built one program and one interest group at a time. And our inability to integrate education, training, and social welfare programs means each is less effective than it could be. Our fiscal and administrative federalism, too, further confounds attempts to address fragmentation. Europeans were more successful with their training systems in the 1980s not only because they spent more—anywhere from five to ten times as much as the United States—but because their training programs were embedded in more cohesive systems of individual support.

At their most profound level, the fragmentation in our policies results in a disconnect between training policies

and employment policies. Notwithstanding the occasional debate over “industrial policy,” employment policy has long since moved beyond explicit programs to the reified world of fiscal and monetary policies. Indeed, when our training and employment policies are related, the relationship is perverse. We provide the most training for workers when private jobs are unavailable. And when jobs do exist, when training would likely have significant positive effects, we retreat from training—in part because training programs didn’t provide work when there wasn’t any.

The policy divide between employment and training reflects a similar disconnect in the popular consciousness. Workforce preparation in the United States is largely driven by general education or through vocational certification in two-year colleges or technical schools, not by training. Total spending on postsecondary education is more

THE FRAGMENTATION OF U.S. LABOR MARKETS ALSO

The European Model?

In Europe, labor unions, private corporations, and governments collaborate in an apprenticeship system to provide real training for real jobs. But workforce development in the United States cannot be modeled on that system. In the first place, U.S. unions aren’t strong enough. Nor are American employers likely to take on big new training responsibilities when cutting costs and

increasing flexibility are primary competitive assets.

More fundamentally, the European apprenticeship systems are rooted in political agreements and a popular solidarity absent from the individualistic and diverse U.S. society. Because European welfare states guarantee extensive income and basic social benefits, they have powerful incentives to educate and train everybody so

that each worker will be sufficiently productive to justify the fixed costs of wage and benefit guarantees.

The United States has no such incentives for universal training investments. Here, the brutal efficiency of the American workforce development system discourages universal policies, and individuals pay the price of education and training failure. Moreover, the more flexible American labor market appears better suited to meet the challenges of global trade and economic restructuring than the highly regulated labor markets that undergird Europe’s training system.

than \$200 billion annually compared with \$7 billion for training.

Expert data support the popular view. In the United States, the earnings returns from education, job training, and access to technology tend to be sequential, complementary, and cumulative. Those who have more schooling have more access to jobs with the most formal or informal training as well as access to more technology, which means they earn more money. And, yes, employers do train. They spend about \$60 billion a year in formal training and another \$180 billion in informal training, but the training extends to the 20 percent of their personnel who already have the most education. That spending will grow in the future. As the college-educated workforce increases between now and 2006, employers will have to spend another \$15 billion just to maintain their current training commitments to their college-educated workers. But the least-educated workers are unlikely to get more employer-provided training.

Trends in the U.S. labor market reinforce the increasing reliance on postsecondary education as the threshold for

workforce development. The shift to service jobs and service functions in all jobs has reduced the value of the kinds of skills learned through training and tended to favor the general cognitive, problem-solving, and interpersonal skills associated with a college education. Even where job-specific training can substitute for education, the effects are often only temporary. The current shortage of technical workers is an example, but will the next computer wipe out the least-skilled computer-related jobs?

What Next?

As the decade closes, public policy promises “college first” for the most advantaged and “work first” at hard labor for everybody else. Work-first policies are consistent with our growing need for mobilization and our commitment to work, and to inclusion through work, but they overlook the decline in

education more explicit in social policy and workforce development policy is not enough, however. By 2015 up to 3 million new 18- to 24-year-old traditional students will enter U.S. colleges and universities each year. Under that pressure, postsecondary education will have few incentives to serve the special needs of nontraditional students. Social welfare and workforce development agencies must overcome the fragmentation in public services for special populations by customizing a broad range of services, including referrals to postsecondary institutions, to meet the complex needs of individual clients on a case-by-case basis.

Outcomes should drive our workforce development system. Employer wage records, already reported quarterly for all civilian workers, should be the cornerstone of the accountability system, as they already are in states like Florida and Washington. Tax credits

critical social services. We might, for example, provide serious training in child care. Such training, along with new tax-incentive programs and regulation, could encourage more people to enter a private child-care market that would be governed by rigorous professional certification. We would thereby promote the common weal and create a whole new wave of high-paid, high-skilled jobs.

Now That All the Poor Are Deserving

The likelihood that we will move beyond the current superficial consensus on training policy to concerted public action will depend on economic, social, and moral considerations. As Keynesian economic policies wane, training may be part of a new solution to link national competitiveness in the yo-yo global economy to the needs of individual workers. Tight labor markets and

MAKES A BROAD-BASED TRAINING POLICY DIFFICULT.

the demand for unskilled labor and the limited mobility out of unskilled jobs. Simply put, most jobs do not provide training of any kind, and individuals without postsecondary skills don't get the jobs that do.

Whither training? The first step seems obvious. We need to continue to struggle with how to integrate social welfare, workforce development, and education policy—a job that only presidents and governors can do. We should formally recognize the silent partnership between education, training, and social policy that has already made postsecondary Pell Grants the universal workforce development voucher for adults, who already receive as much as \$3 billion from those grants. The use of Pell Grants to achieve social welfare and employment policy goals has fallen off since the shift in emphasis to “work first.” But 476,000 AFDC recipients and their dependents used Pell Grants as recently as 1997. And in 1992, the last year for which data were available, 75,000 dislocated workers used Pell Grants, many in combination with federal student loans.

Making the role of postsecondary

would encourage employers to train their first-level supervisors and non-supervisory employees. Increasing credits for employers who use state-certified education and training institutions would strengthen relationships between certified training providers and employers.

Realistically speaking, the key policy issue for the United States is the longstanding disconnect between training policies and jobs. Although a national dialogue on job creation seems superfluous now, the next debate over jobs is only as far away as the next recession. When work disappears in a work-first policy world, we will have to decide whether to warehouse workers until jobs return or make another try at connecting employment and training policies.

A serious policy dialogue that links training with job creation will have to be about services because that is where the good jobs are growing. Almost all of America's impressive job creation in high-wage services has come in private business services. An employment and training strategy for the postindustrial era would invest in undercapitalized

universal training policies would be a unique mix in American politics. But this time, full employment feels different. Even if job tenure stays put in the official data, the public expectation for job security is clearly not being met. Training is no substitute for a good job, but it might help get one and, barring more aggressive employment policies, it is all the government can offer. For the same reasons, training policies are a sure part of the consolation package for affected workers the next time we decide to save the odd endangered bird, beetle, or trade bill. And if the American job machine doesn't produce a sufficient quantity or quality of jobs, political pragmatists will reach first for training and then, eventually, for employment policy solutions.

The social and moral impetus for training policy depends on our tolerance for income inequality in our diverse society and the strength of our commitment to social mobility. Post-welfare reform work-first policies have exposed the issue of working poverty. Now all the poor are “deserving,” and training programs are one way to make work pay. ■

Job Security in Is Lifetime Employment on the Way Out?

By Edward J. Lincoln

Japanese labor markets provide a stark illustration of how varied labor practices can be in other industrialized nations, as well as some dangers in attempting to enhance employment stability.

Since the 1950s, Japan's labor markets have been characterized by several distinctive features. Perhaps the most notable among them is "lifetime employment," the practice at large firms of hiring workers directly out of school and retaining them until a mandatory retirement age (originally age 55, now around 60 for most companies). The lifetime guarantee is implicit, with no written contracts, but real nevertheless and estimated to cover about a third of all workers. Rather than hiring mid-career managers or blue-collar workers from the outside, firms promote exclusively from within.

A related feature of Japan's labor markets is steep seniority-based pay. As part

of the incentive for employees to remain with the firm under a lifetime employment guarantee, wages follow a steep seniority profile. In addition, corporate pensions are not portable.

To absorb those workers not fortunate enough to enter large corporations practicing lifetime employment, Japan's government protected several sectors of the economy (including agriculture, retailing, and construction) from large firms and international competition. These protected sectors, with their characteristically small labor-intensive firms and flexible wages, readily absorbed workers.

A final distinctive characteristic of Japan's labor market is weak company unions. Efforts to create American-style craft unions in Japan shortly after World War II were snuffed out, and unions today are predominantly company-based.

Fraying Badly Around the Edges

For years, many Japanese extolled the virtues of their labor markets. Unemployment was very low (under 1 percent in the 1960s, creeping up to a 2-3 percent range in the 1980s). Strikes were few (at least after a fairly turbulent period in the late 1940s and early 1950s) and eventually reduced to very short-term ritual demonstrations. The lack of craft unions and the guarantee of employment at large firms supposedly made workers more receptive to technical change than their American counterparts. And management believed that a worker's productivity increased continuously with length of employment, justifying their "lifetime" employment commitment.

But as a result of almost a decade of poor economic performance, today the system is fraying badly around the edges.

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DIEGO GOLDBERG/SYGMA

From 1992 to 1997, Japan's economy grew at an average rate of only 1 percent, and since then has entered a real recession. Employment today is no higher than it was in 1992 and is currently falling at about a 1 percent annual rate. Part-time workers make up a rising share of total employment (24 percent in 1998, compared with 20 percent in 1992). Meanwhile, the unemployment rate has more than doubled since 1992, from 2.2 percent to 4.8 percent. In Japan, there is now a bulge in unemployment rates for both young workers (9.1 percent) and those aged 55 to 64 (5.6 percent) who either reached the mandatory retirement age or were forced into early retirement. These employment and unemployment data may not look serious from an American point of view, but have been quite shocking to Japanese.

Resistant to Change

When Japan's economy was growing rapidly, lifetime employment appeared to be a reasonable choice: large firms, after all, rarely experienced an economic downturn sufficiently long or deep to require cutting employment. But in a

slow-growing economy with real recessions, the commitment not to fire workers slows the downward adjustment of employment. In addition, during the rapid growth years, the addition of new workers only at the bottom of the pay scale helped to hold down wages as employment expanded. But with employment flat, the total wage bill continues to rise because of the steep seniority-based pay scale.

Nor is all well in the small business sector that traditionally absorbed workers. The consequence of a quarter-century of protecting farmers, small shops, construction firms, and other industries has been high prices. Dissatisfaction with these prices has led to at least some decline in protection for agriculture and the retail trade.

If the existing system can no longer provide low unemployment or contain costs for large corporations, why not just get rid of it? The government's latest annual Labor White Paper makes such a suggestion, advising people to grow accustomed to the idea. But will this really happen? Longevity of membership has been a central part of Japanese group behavior. At the very least, large

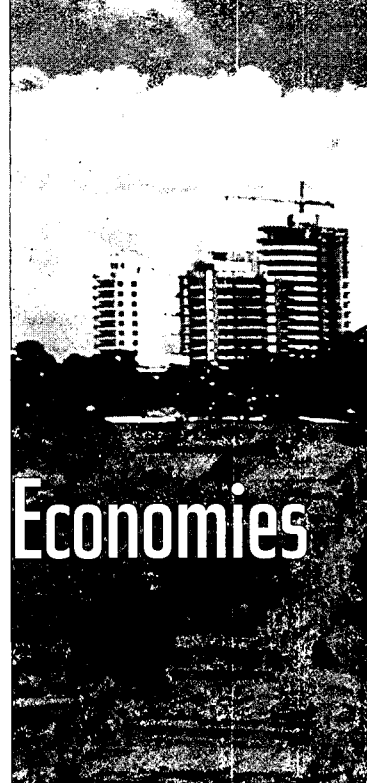
corporations would have a difficult time finding alternatives to building trust and loyalty among employees. Individuals would also need to shed the sense of shame and humiliation attached to unemployment, or the deep anxiety attached to having to seek employment entirely on one's own.

The more likely outcome over the next decade is that the current system will be modified, rather than eliminated. Some core of employees will continue to gain an implicit lifetime employment guarantee, though that may involve acquiescence in being shunted off to a job arranged by the paternalistic employer when times are bad. Some move toward merit-based pay will occur, but wage profiles will probably remain more seniority-oriented than they are in the United States. Some companies may adopt stock options for managers, but the notion of creating pockets of enormous wealth for some managers will be sufficiently troubling to prevent the practice from becoming widespread. In short, having lived comfortably with a distinctive set of labor practices for half a century, Japan is finding them difficult to discard. ■

New Markets, New Opportunities?

Mobility Issues in the Emerging Market Economies

By Nancy Birdsall and Carol Graham



The dramatic entry of the emerging market countries into the global economy has brought issues of inequality and opportunity front and center worldwide. Indeed, as the recent international financial crisis has highlighted, even in the most successful fast-growing economies in Latin America, Eastern Europe, and Asia, global markets can bring, along with better opportunities, increased inequality and insecurity for individual citizens.

We focus here on Latin America, but similar questions are being raised wherever market reforms spurred by global integration have heightened concern about inequality. Because most countries in Latin America (and many elsewhere) are in the midst of quiet but profound political transitions to more democratic and more decentralized political systems, the inequality issue has political implications as well.

Nancy Birdsall, senior associate, Carnegie Endowment for International Peace, and Carol Graham, co-director of the Center on Social and Economic Dynamics at Brookings, are co-editors of New Markets, New Opportunities? Economic and Social Mobility in a Changing World (Brookings and Carnegie Endowment for International Peace, 1999).

Explaining a Puzzle

In Latin America the market reforms of the 1990s have been accompanied by persistent, even heightened inequality. Increasingly dynamic and competitive markets have conferred most of their rewards on those with the wherewithal (property, connections, and, increasingly in the information age, education and skills) to exploit the new rules. Insecurity is also on the rise. Even people with good jobs and rising income work in more volatile and flexible labor markets, with globalized markets requiring constant adjustments in the nature and location of production and thus of jobs.

Chile stands out in Latin America as a leader in implementing market reforms, sustaining growth, and reducing poverty, while making a successful transition to

democracy. Yet even in Chile, more than 60 percent of respondents in a recent poll favored increasing equality over increasing productivity, and more than 90 percent favored increased government spending on health, education, and pensions. Still, despite apparent concerns about inequality, most voters in Chile, as elsewhere in the region, have consistently endorsed market policies over the past decade. How is one to account for Latin American voters' continued support for reforms despite persistent or increasing inequality?

One explanation is that the collective memory of the high inflation and macroeconomic volatility of the 1980s forged a public consensus in favor of market discipline. That explanation has a limited life, however, as most countries of the region



P. FRIDMAN/SYGMA

have now managed relatively low inflation for years. Voters may instead be prompted by a more enduring disdain for a state that is too big, too ambitious, and potentially too corrupt—and they may be endorsing a profound change in its role. Voting trends may thus reflect a view with potentially more lasting implications, namely that a more efficient state and greater reliance on more open and dynamic markets can bring not only inequality and insecurity, but also greatly increased and more broadly shared opportunities.

Good and Bad Inequality

Inequality, depending on its nature, can be primarily constructive or destructive. A view popular in the United States is that inequality spurs economic growth by rewarding productivity and innovation and by supporting new opportunities. But inequality may also be destructive if it reflects entrenched differences in the capacity of individuals and households to exploit markets or in their access to education, employment, or property rights. Such inequality can discourage the poor from investing in their future.

Latin America's history of high inequality reflects, at least in part, a history of unequal opportunity. Until recently,

labor laws made it virtually impossible to fire workers once they were contracted, thus discouraging hiring. Pockets of workers were privileged and overprotected, while the majority were driven into the informal economy. Inadequate regulatory and judicial systems often allocated services in response to bribes and other forms of influence peddling by wealthy individuals or firms. The poor, unable to negotiate the system to legally register their homes or small businesses, were left without titles and without the collateral to borrow and invest. Shallow financial sectors, often operating at negative rates of real interest, rationed credit, which inevitably went to large public enterprises or to influential firms, leaving small and medium-sized businesses unable to borrow to increase their size and efficiency.

By eliminating distortions that blocked the productive potential of the poor, market reforms should, at least in theory, open up new opportunities. Voters in Chile and throughout Latin America may thus be endorsing a deep shift, from closed to open societies, and to increased opportunity for all income groups.

Trends in Opportunity

What voters perceive and endorse, however, is not easily assessed and quantified

by social scientists. Changes in the distribution of income take years, even decades, to unfold. Underlying changes in the distribution of opportunity are harder still to observe. Income in Chile remains as inequitably distributed today as it was in the 1960s, despite all the reforms and major reductions in absolute poverty in the past 10 years. In most other countries in the region, measures of income inequality also remain largely unchanged. Yet these data tell us little about what happened to opportunity and mobility in the aftermath of market reforms. Nor do they tell us how or whether those reforms will affect future distribution patterns. Significant increases in mobility among younger low-income cohorts as a result of market reforms, for example, might make distribution more equitable in the future, but those improvements could be captured only by measuring distribution patterns in 10 or 20 years.

Charting trends in mobility and opportunity in the emerging market countries is particularly difficult because, unlike the industrialized countries, developing countries rarely collect long-term data relating to individual welfare changes. Detecting these trends requires modifying existing data sets to create proxy long-term (panel) data, as well as generating new long-term data. We do,

however, have some indicators of recent trends in mobility and opportunity in emerging market countries, as well as some new evidence of how individuals *perceive* they have fared under market reforms and how those subjective perceptions relate to objective trends.

According to a recent analysis of Latin American household data by Jere Behrman, Nancy Birdsall, and Miguel Szekely, strengthened financial markets and increased public spending on basic education enhance intergenerational mobility, reducing the role of family background in determining individuals' mobility paths. Though the immediate effects of market reforms and education policy are not evident in any improvement in the distribution of income, it is likely that they will enhance mobility rates—and may make distribution more equitable—over the long term.

In the shorter term, market reforms have favored some groups over others. Younger, better-educated, and skilled workers—those in short supply because of the region's poor record in educating its labor force—have fared the best. David Hojman, for example, has found that while income in Chile has increased across the board, rewards to managerial (skilled) personnel have outpaced those to workers as much as five to one.

Sustainable Reform

Understanding how these trends in mobility and opportunity translate into voter behavior requires taking into account people's *perceptions* of their past mobility trends, as well as their assessments of their future prospects of upward mobility.

Carol Graham has analyzed region-wide public opinion surveys in Latin America in 1997 and 1998, in which respondents were asked to compare their living standards with those of their parents, as well as to assess their own prospects of upward mobility. Younger

cohorts (ages 18–29) were the most optimistic, both about their standing relative to their parents and about their future mobility. More educated groups also tended to be more optimistic in most countries, though in some, such as Brazil and Bolivia, the least educated groups were the most optimistic.

In another study, Richard Webb compared actual economic progress of selected households in Peru between 1985 and 1997 with respondents' own assessments of their progress and prospects. Actual mobility over those years was quite high, as Peru moved from extreme economic crisis during the mid-1980s, to severe stabilization measures, and then finally to a growth surge. Most households in the study enjoyed significant improvements in their per capita income: 61 percent had increases of 30 percent or more. Responses to subjective questions regarding current and past economic status, however, were sharply and negatively skewed, with the highest performers having the most negative self assessments.

There are a variety of explanations for this anomaly, including higher expectations among more educated, urban groups, reluctance to make definitive statements among rural respondents, and difficulties in accurately assessing earnings and income trends, particularly by self-employed individuals. Another plausible explanation is that the increased uncertainty accompanying the turn to the market encourages negative assessments of progress and that those who have found new opportunities feel little guarantee of their stability. Regardless of the explanation, the results highlight a worrisome finding from a political economy perspective: some of the clearest winners in the market process do not perceive that they have experienced upward mobility.

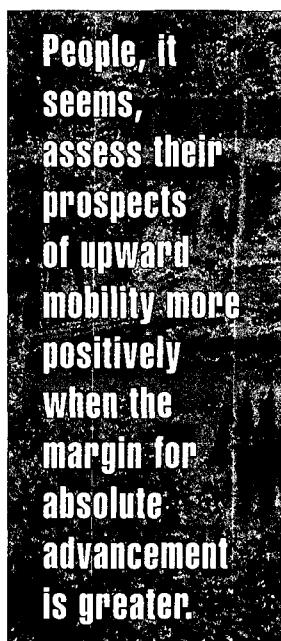
The counter-intuitive nature of Webb's findings for Peru is com-

mented by regionwide results, in which some of the brightest assessments of prospects for upward mobility were in some of the worst-off countries with poor growth trajectories and high inequality. People, it seems, assess their prospects of upward mobility more positively when the margin for absolute advancement is greater. In a similar vein, Richard Easterlin's research on industrialized countries finds that as absolute income levels go up, relative income differences matter more to people's assessments of their well-being.

The Way Ahead

In a global system that seems unfair and unstable, Latin American democracy and open markets have been strengthened, belying concerns about isolationist backlash and resort to authoritarian populism. How sustainable is this trend? Our findings thus far are ambiguous. Although deeper markets and better schools encourage mobility and opportunity in the emerging market countries, the new markets are rewarding some groups much more than others. These relative income differences may matter as much as, if not more than, absolute ones (at least above a certain level of income) as people assess their economic well-being and progress, which may explain why even some of the winners in the market process are so negative about their progress. That in turn may have important if as yet unrealized effects on the political sustainability of market policies.

The challenge for policymakers is to continue to deepen and support markets while pursuing policies that can increase opportunity for lower-income groups. Education is one area where both objectives can be achieved. Purely redistributive policies that attempt to equalize outcomes as well as opportunities have a more checkered record. Yet the importance that even highly mobile individuals attach to relative income differences in the new market economies suggests that inequality is an issue that is not going to go away, even in the context of fast-paced growth, and that addressing it in novel and creative ways may ultimately be critical to the sustainability of the worldwide turn to the market. ■



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